NORTHUMBRIAN WATER LIMITED ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2017

NORTHUMBRIAN WATER living water

ESSEX&SUFFOLK WATER living water

Registered company no: 02366703

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2017

CONTENTS **PAGE**

STRATEGIC REPORT

BOARD STATEMENT – OUR VISION AND PERFORMANCE

This statement sets out how we, the Board of Northumbrian Water Limited, set the Company's aspirations for customers, structure management rewards to incentivise delivery of these aspirations, and ensure that we are transparent and accountable to customers in reporting on performance.

The Board has a long-term vision for the Company, which is to become the national leader in the provision of sustainable water and wastewater services. This will require us to deliver outstanding service to our customers across our water and wastewater businesses as well as maintaining the highest levels of environmental performance.

HOW WE SET OUR ASPIRATIONS

The aspirations that we have set for the business were developed through a process of engagement and consultation with customers and other stakeholders as part of our business planning process for the period 2015-20. This engagement led to a set of agreed outcomes for customer service, the environment and the way in which we manage the business.

For each of these outcomes we also agreed a range of measures of success and challenging performance commitments, which we use to monitor and report on performance. The outcomes, measures of success and performance commitments are set out on pages 16 to 17 of this report.

In addition to the performance commitments for the agreed outcomes we have also set ourselves tougher, stretching targets within the business. These targets are driving the year on year performance improvements necessary to deliver our vision of being national leader. These targets are reported internally through a balanced scorecard of key performance indicators which cover the full range of strategic themes that underpin the vision.

In order to ensure that the Executive Leadership Team's focus is aligned with the business outcomes we want to attain, the stretching internal targets represent 90% of the potential value of the short-term incentive plan for our Directors, with a further 10% available for the achievement of bespoke personal targets. The Remuneration Committee Report on pages 63 to 73 provides full, transparent detail on our directors' remuneration policy and how remuneration in the year has been calculated.

PERFORMANCE IN 2016/17

Our performance in 2016/17 is described in detail in our Annual Performance Report, a separate report available on our websites, and on pages 15 to 38 of this report. The information provided is supported by case studies that illustrate where we are adopting particularly participatory or innovative approaches in the way we deliver services.

We have delivered year on year improvement against the majority of measures and have achieved our performance commitments in a very high proportion of our Customer and Environment measures of success.

In respect of customer service, as measured by Ofwat's Service Incentive Mechanism (SIM), we are pleased to be joint first in the industry for customer satisfaction. We also expect to be at, or close to, industry leading on the overall SIM measure. Our Unrivalled Customer Experience Strategy was co-created with our customers, allowing us to understand what is really important to customers. As part of this strategy, we engage with customers on an ongoing basis and use their responses and feedback to shape and improve services even further.

As a company we believe strongly that working in partnership delivers better results for all. We demonstrate this belief across all aspects of our business, for example in the environmental partnerships we have formed in support of our catchment management approach in our water business and in developing sustainable urban drainage solutions in our wastewater business. We take particular care to support vulnerable customers, and have developed a close partnership with debt charity StepChange to help customers who are experiencing financial difficulties. We have also developed collaborative working arrangements with supply chain partners to deliver our capital investment programme more efficiently and deliver better outcomes for customers.

We welcome the key role that our Water Forums play in providing challenge on behalf of our customers. As part of this process we report to and discuss our performance with the Water Forums and they provide their independent commentary within our Annual Performance Report.

The Water Forum commentary in the Annual Performance Report highlights a number of performance improvements during 2016/17 that directly benefit our customers:

- achieving industry-leading levels of customer satisfaction, recognising the profile that is given to customer service across the business;
- delivering our best-ever result on discoloured water customer complaints, which has been an area of concern in the past;
- the approach taken to managing interruptions to water supply for customers, which has resulted in us exceeding our performance commitments;
- a positive trend in sewer flooding incidents inside and outside customers' properties, meaning fewer people are affected;
- improvements to bathing water quality in our area of operation in the north east of England; and
- the improvement in category 3 pollution incidents and the creation of a dedicated team to work proactively to address and reduce pollution incidents.

As a business we are always seeking to improve and have therefore accepted the challenge provided by our Water Forums to consider a number of areas where they believe there is a need or opportunity to improve performance and outcomes for customers through:

- seeking ways to go even further beyond our performance commitments for sewer flooding and interruptions to water supply;
- having a clear ambition and taking action to reduce category 1 and 2 pollution incidents;
- understanding, through conversations with customers, the issues causing us to miss our performance commitment for customer satisfaction with drinking water taste and odour, and taking steps to address this;
- helping customers better understand the context of some of our performance measures by making them more meaningful;
- having a clear strategy for preventing issues with the private drains and sewers transferred into the company's responsibility in 2011, including through customer education;
- taking a leading role in the industry on ways in which to measure the average water each person uses; and
- showing more historical data in future Annual Performance Reports so that customers can see what the trends are.

As a Board, we remain committed to continuing our drive to be the national leader and to deliver outstanding service to our customers and other stakeholders. We aim to improve our performance year on year and to meet, or exceed, our performance commitments. In particular, we will seek to address all of the areas identified by our Water Forums on behalf of our customers.

Signed on behalf of the Board of Northumbrian Water Limited:

Andrew J Hunter Chairman	**Heidi Mottram** Chief Executive Officer	**Paul Rew** Senior Independent Non-Executive Director

ASSURANCE

This Board Statement forms part of our Strategic Report and, as such, falls within the scope of our Independent Auditor's Report on pages 108 to 109. Our separate Data Assurance Summary describes how we ensure that the information we report is accurate, clear and transparent and the assurance that the Board has received on our performance and compliance for 2016/17. This can be found on our websites at www.nwl.co.uk and www.eswater.co.uk.

CHAIRMAN'S STATEMENT

I am pleased to introduce the Annual Report and Financial Statements of Northumbrian Water Limited for the year ended 31 March 2017.

A J Hunter

Northumbrian Water Limited (NWL or the Company) continues to strive to achieve its published vision to become the national leader in the provision of sustainable water and wastewater services and our Chief Executive Officer (CEO), Heidi Mottram, confirms in her report that we have made good progress across most of our key measures of success during 2016/17. NWL remains absolutely committed to consistent delivery of outstanding customer service, and operational excellence remains central to this.

Our progress is underpinned by our five strategic themes: Customer, Environment, Competitiveness, People and Communities. Our Strategic Report sets out our work and achievements within each of these themes. The Board reviews performance against a balanced scorecard of measures relating to the strategic themes at each meeting.

The whole Company is aligned to delivery of an unrivalled customer experience and I am delighted that we have achieved national leader status for customer satisfaction, as well as a high level of customer trust. As Heidi explains in her report, we have worked very collaboratively with our stakeholders to build on our solid foundations in these areas. The Company's open and honest approach to customers is one key element of a corporate culture built on clear values; customer focused, creative, results driven, ethical and one team. We constantly remind ourselves of these values and sense-check all our business decisions against them. I firmly believe that this approach has helped us build a first class culture, with customer service at its heart. There is a very strong public service ethos here
at NWL.

I am also very pleased that our operational performance has been excellent overall. We have delivered extremely high water quality, low interruptions to supply, first class wastewater treatment compliance, good progress in reducing sewer flooding, and bathing waters in the north east all meeting the required standard.

Within the People theme, the wellbeing and safety of our employees is of paramount importance and a full Health and Safety (H&S) update is a key item we consider on each Board agenda. This is a top priority for the Board, which reviews the H&S updates carefully and invests significant time with the Company's management to ensure that the H&S strategy is delivering good performance. The Company is developing a comprehensive 'safety culture' to increase awareness of risk and encourage employees to see safety as absolutely central to everything we do.

The Company's excellent customer service and operational performance are supported by the high corporate governance standards maintained by the Board. Full details of our corporate governance arrangements are set out in the report on pages 49 to 62.

In common with all water and sewerage companies, NWL needs to invest heavily in maintaining and, when necessary, replacing plant, equipment and facilities in order to ensure a reliable and high quality service. It also needs to pay a return to investors and lenders. Sound financial performance is therefore essential and I am pleased to confirm that the Company has retained its strong investment grade credit ratings and remains well within its financial Key Performance Indicator (KPI) targets, reported in the balanced scorecard on pages 16 and 17 under the Competitiveness theme. There are, however, challenges ahead and work is already underway on the next regulatory price review.

As Heidi confirms in her report, the Company's preparations for the opening of the non-household (NHH) retail market on 1 April 2017 were very thorough and NWL exited the market on that date, transferring its NHH customers to NWG Business Limited (NWGB), Northumbrian Water Group Limited's (NWGL) NHH retail subsidiary, or to alternative retailers chosen by the relevant customer. NWL is working very hard to ensure that it will be an effective and efficient wholesaler of water and wastewater services to retailers as customers, whilst continuing to provide first class services to its domestic customers.

I can assure our stakeholders that NWL's responsibilities as a significant supplier of water and wastewater services are recognised fully by the Directors and influence all key decisions.

The Board will continue to drive the performance of the Company forward to ensure that all our customers are delighted with our services in 2017/18 and beyond.

Last year, we combined what had previously been two separate documents, the Financial Statements and the Annual Performance Report (APR), into a single document, transitioning to new accounting standards and reporting under revised regulatory guidelines set out by the Water Services Regulation Authority (Ofwat).

After careful consideration and consultation, we have decided that it is clearer and more transparent to our stakeholders to publish our APR as a separate document and we will do so this year. We will also again be publishing additional information about our performance and governance arrangements in a more customer-friendly style on our websites.

Finally, I would like to thank all our employees for their dedication and commitment this year. Our performance depends entirely on our people and, as always, they have exceeded expectations.

Andrew J Hunter
Chairman

CHIEF EXECUTIVE OFFICER'S REPORT

I am pleased to introduce our Annual Report and Financial Statements for the year ended 31 March 2017.

H Mottram

Our vision is to be the national leader in the provision of sustainable water and wastewater services, and I am delighted that we have made further progress towards this and remain at the forefront of performance in our industry. We have included a number of case studies in this report to demonstrate some of the innovative approaches we have adopted to deliver this performance.

OUR PERFORMANCE

I am particularly proud that we have achieved national leader status for customer satisfaction as customers are at the heart of our business. I believe that this is a result of the work we carried out last year with the participation of our customers, as well as our employees and supply chain partners, to develop our unrivalled customer experience strategy. I am also proud that the Consumer Council for Water (CCWater) have found that we are the most trusted water company for the last three years.

We recognise that some of our customers face real challenges with affordability and continue to work closely with our partner, debt charity StepChange, to provide support and advice to customers experiencing financial difficulties. We have also worked this year on a number of initiatives with other utility companies across the north to jointly promote and align how we support vulnerable customers.

Our water business continues to provide a reliable and resilient supply of clean water to our customers, and we have continued our industry leading performance in lowest interruptions to supply and maintained 100% security of supply. We have reinforced our award winning approach to water efficiency through our Every Drop Counts campaign through which we engage with customers on a whole town approach helping them to save water, energy and money.

The quality of the water we produce remains exceptionally high and we have made further progress tackling discolouration of water. We take an active catchment management approach to improving the quality of water in the environment and have forged a number of environmental partnerships allowing us to pool our knowledge and resources and work more effectively together.

In our wastewater business we remain committed to reducing the risk of sewer flooding and are adopting a wide range of innovative approaches to achieve this, including working in partnership to deliver sustainable urban drainage solutions and engaging with communities through our RainWise initiative and Love Your Drain campaign. The impact of this can be seen through further reductions in the number of flooding incidents.

In the wider environment, we continue to deliver excellent levels of wastewater treatment compliance and are committed to minimising the risk of environmental damage from our network through initiatives such as our Water Rangers scheme. We are proud that all of the bathing waters in our north east operating region met the required standard and that we have the highest proportion meeting the good or excellent standard in England.

We recognise that to achieve our business priorities we must innovate continually and have adopted a design sprint approach to tackle key challenges, pushing the boundaries of what is possible and how quickly we can be deliver solutions. We are also working with partners from across the utility sector to tackle the problem of future skills shortages by engaging with schools, investing in apprentices and sponsoring research, particularly in the science, technology and engineering disciplines.

MARKET CHANGES

One of our major areas of focus this year has been on preparing for the opening of the competitive NHH retail market. The new market opened on 1 April 2017 and allows all NHH customers to choose their retail supplier. Under our Ready4Retail programme we have undertaken a major programme of activities including implementing two new billing systems, restructuring parts of our organisation and communicating with our customers about the changes. With the support of external assurance partners, our Board was able to confirm to Ofwat and Market Operator Services Limited (MOSL) that we had satisfied all of the market entry requirements and were ready for market opening from both a wholesale and retail perspective.

As NWL, we have chosen to exit the retail market and transfer our NHH customers to NWGB, another NWGL subsidiary. This decision was taken to allow us to demonstrate transparently that, as a wholesaler, we will work with all retailers on an equal basis and will continue to provide excellent wholesale services to all. More information on this transfer can be found in NWGL's Annual Report and Financial Statements.

LOOKING FORWARD

Although we have only just completed the second year of the current price control period, we are already developing our plans for the next price review. Understanding what our customers want is central to what we do every day and we have commenced an extensive programme of customer participation workshops to help inform our future plans, as well as working with our Water Forums. We are also continuing to engage with Ofwat and their 'Marketplace for Ideas' to help shape the future of the industry.

From a personal perspective, I was honoured to be appointed as The Prince of Wales' Ambassador in the North East through Business In The Community (BITC), the Prince's responsible business network. I passionately believe that business has a critical role in making a lasting, meaningful and positive difference to our communities and the environment. At NWL, we've shown how businesses can work innovatively in partnership to help make sure the places we live and work remain special and thriving environments for generations to come. Over my two years as an Ambassador I hope to bring together other businesses and partners from across different sectors to tackle some of our most challenging issues and build resilience and create a more sustainable future for us all.

We are proud of our achievements to date, but we are never complacent and will continue to make further service improvements in 2017/18 and beyond. I hope you find our Annual Report and Financial Statements helpful and informative.

H Mottram OBE
CEO

We have chosen to produce separate reports this year for our Financial Statements and our **APR** *so that we can enable our stakeholders to more easily access the information which is of most interest to them. We will also produce our '***Contribution Report***' which presents the social, environmental and economic impact we have on the communities we serve. Finally, we have produced a separate* **Data Assurance Summary** *setting out how we ensure that the information we report is accurate, clear and transparent. All of these documents are available on our websites at* **www.nwl.co.uk** *and* **www.eswater.co.uk**.

BUSINESS OVERVIEW

Our vision is to be the national leader in sustainable water and wastewater services.

We provide water and wastewater services to our customers in the north east of England, trading as Northumbrian Water (NW), and water services only to our customers in the south east of England, trading as Essex & Suffolk Water (ESW).

We employ over 3,000 people

2.7 MILLION

NW supplies water and wastewater services to 2.7 million people in the major population centres of Tyneside, Wearside and Teesside as well as the large rural areas of Northumberland and County Durham. We provide wastewater services only in Hartlepool.

1.5 MILLION IN ESSEX

0.3 MILLION IN SUFFOLK

ESW supplies water services to 1.5 million people in Essex and 0.3 million in Suffolk. Our Essex area is part rural and part urban and includes the main population centres of Chelmsford, Southend and the London Boroughs of Barking and Dagenham and Havering and Redbridge. Our Suffolk area is mainly rural with the largest towns being Great Yarmouth and Lowestoft.

We operate and maintain:

- 55 water treatment works;
- 303 water pumping stations;
- 326 water service reservoirs;
- 25,678km of water mains;
- 413 sewage treatment works;
- 931 sewage pumping stations; and
- 29,923km of sewers.

Every day we supply 1.1 billion litres of water

NWL is part of the Northumbrian Water Group (the Group). The ultimate parent undertaking of NWL is CK Hutchison Holdings Limited (CKHH), a company listed on the Hong Kong Stock Exchange. Further information about the structure and ownership of NWGL is provided on page 39 of this report.

OUR HIGHLIGHTS

NUMBER ONE FOR CUSTOMER SATISFACTION

Joint 1st Service Incentive Mechanism (SIM) score

MOST RELIABLE SUPPLY OF WATER

Industry leading performance on interruptions to supply

100% OF BATHING WATERS MEETING TIGHTER REGULATIONS

All designated bathing waters 'Sufficient' or better under the Bathing Water Regulations

REDUCED SEWER FLOODING

Continuing trend of reductions in repeat and internal sewer flooding incidents

100% OF SEWAGE SLUDGE CONVERTED TO RENEWABLE ENERGY

Benefitting customers and the environment

30% REDUCTION IN GREENHOUSE GAS EMISSIONS SINCE 2008

Through reduced usage and generation of renewable energy

ROSPA GOLD MEDAL AWARD FOR 5TH CONSECUTIVE YEAR

Recognising Health and Safety performance and culture

LIVING WAGE EMPLOYER

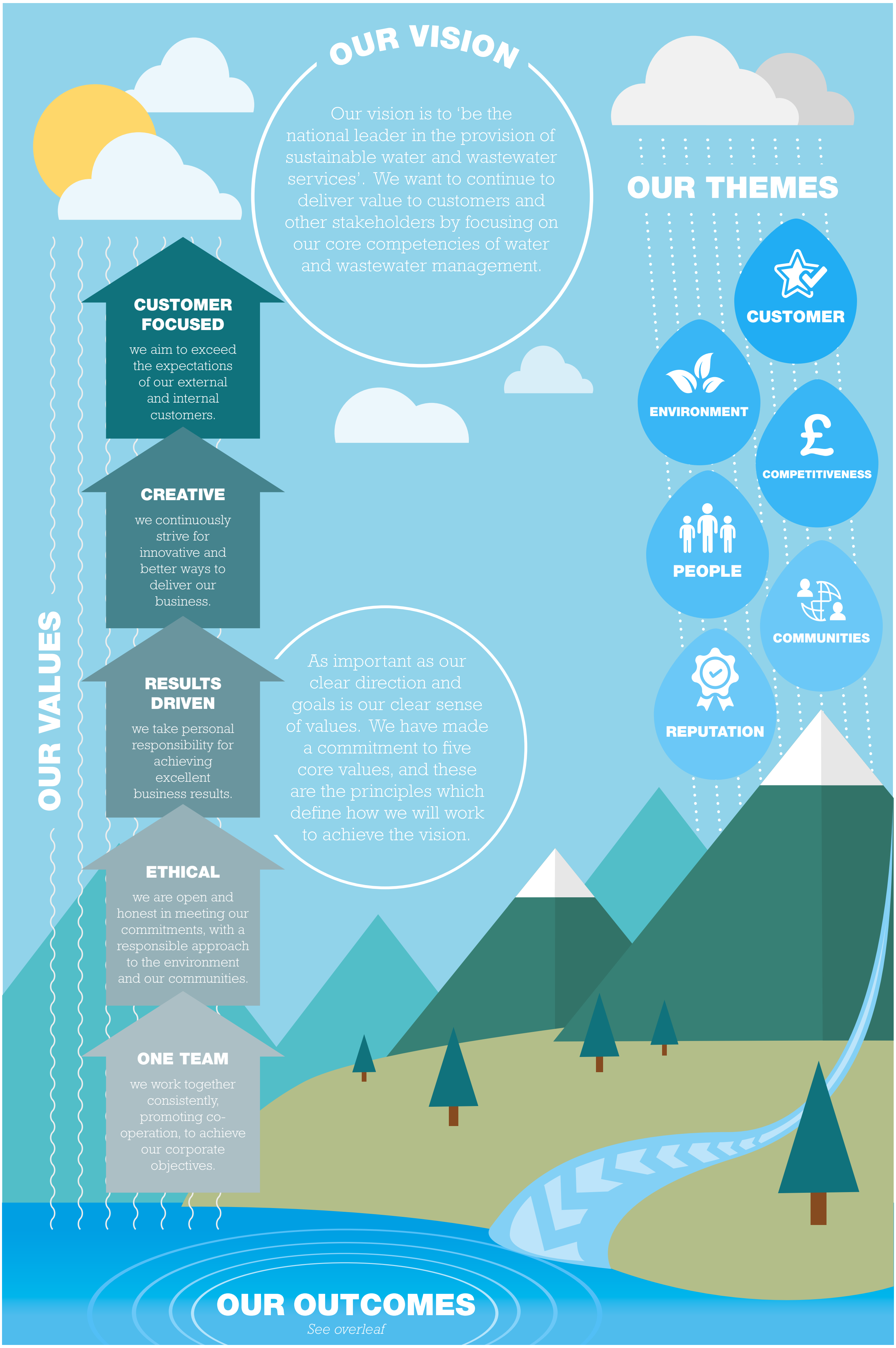
Accredited by Living Wage Foundation

MOST TRUSTED WATER COMPANY FOR 3RD YEAR RUNNING

From research by CCWater

ONE OF WORLD'S MOST ETHICAL COMPANIES

Only water and wastewater company in the world on Ethisphere list


OUR VISION
Our vision is to 'be the national leader in the provision of sustainable water and wastewater services'. We want to continue to deliver value to customers and other stakeholders by focusing on our core competencies of water and wastewater management.
OUR THEMES
CUSTOMER
ENVIRONMENT
COMPETITIVENESS
PEOPLE
COMMUNITIES
REPUTATION
OUR VALUES
CUSTOMER FOCUSED
we aim to exceed the expectations of our external and internal customers.
CREATIVE
we continuously strive for innovative and better ways to deliver our business.
RESULTS DRIVEN
we take personal responsibility for achieving excellent business results.
ETHICAL
we are open and honest in meeting our commitments, with a responsible approach to the environment and our communities.
ONE TEAM
we work together consistently, promoting co-operation, to achieve our corporate objectives.
As important as our clear direction and goals is our clear sense of values. We have made a commitment to five core values, and these are the principles which define how we will work to achieve the vision.
OUR OUTCOMES
See overleaf

OUR OUTCOMES

THEME	OUTCOME
CUSTOMER	• We deliver water and sewerage services that meet the needs of current and future generations in a changing world • We supply clean, clear drinking water that tastes good • We provide a reliable and sufficient supply of water • Our customers consider the services they receive to be value for money • Our customers are well informed about the services they receive and the value of water • We provide a sewerage service that deals effectively with sewage and heavy rainfall • We provide excellent service and impress our customers
ENVIRONMENT	• We help improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife • We protect and enhance the environment in delivering our services, leading by example
COMPETITIVENESS	• We are an efficient and innovative company • Our finances are sound, stable and achieve a fair balance between customers and investors
PEOPLE	• Our people are talented, committed and inspired to deliver great services to customers • Our people act in line with our values • We are seen as a great place to work • Our workplaces are healthy and safe
COMMUNITIES	• We are proud to contribute to the success of local communities • We work in partnership towards common goals
REPUTATION	• We are a company that customers trust

OUR STAKEHOLDERS

We provide essential services to our customers and, as a licenced water and wastewater undertaker, we operate within a strict regulatory environment. It is very important to us that we understand the needs of these and our many other stakeholders to ensure that we continue to provide a great service and deliver our business outcomes. We engage proactively with all of our stakeholders in our continuing efforts to provide an unrivalled customer experience.

CUSTOMER VOICE

We invite our customers to participate in and co-create our strategy and approach to customer service, levels of performance commitments and specific matters such as the design of our billing literature. We use many methods of engagement, including focus groups, co-creation workshops and our mobile engagement hub, as well as social media and surveys.

Our Water Forums, one each for our NW and ESW customers, bring together a range of experts from various stakeholders to challenge the Company on behalf of our customers. They inform our approach to customer research and engagement on matters such as performance commitments and social tariffs research as well as challenging us to consider areas where performance and outcomes for customers could be improved.

On a national and regional basis, customers' interests are represented by CCWater. We share and review customer literature with them before publication and engage on how we support vulnerable customers, as well as holding quarterly liaison meetings and attending regional public meetings.

GOVERNMENT AND REGULATORY CONTEXT

Ofwat regulates prices and levels of customer service. We engage on key issues such as market reform and future price controls as well as the need to demonstrate strong governance and the importance of maintaining the trust and confidence of our customers. This is achieved through our regular reporting, such as our APR, responding to consultations, regular peer to peer contact and participating in the market place for ideas.

The Drinking Water Inspectorate (DWI) monitors drinking water quality and we engage at both an operational and strategic level to review performance and promote good practice, in addition to reviewing specific improvement schemes.

The Environment Agency (EA) covers environmental protection and we liaise on our environmental performance, discharge compliance and sewer flooding. In addition to regular performance reviews, we have worked collaboratively through catchment partnerships and providing input to the 21st century drainage programme.

OUR PEOPLE AND DELIVERY PARTNERS

We engage with our employees both through our Employee Relations Framework and via a range of communication channels, such as team briefings, director roadshows and regular internal communications. This covers a wide range of subjects from H&S and staff benefits to values and behaviours and diversity. Our approach is described in more detail in the Performance section, under the People heading on pages 31 to 35.

To meet the challenges of delivering our AMP6 (Asset Management Plan) capital investment programme as efficiently and effectively as possible, we implemented a new operating model with our supply chain, based around collaboration and co-operation. This involves joint framework governance groups, integrated programme delivery teams, joint recruitment campaigns and a joint framework for H&S, co-created with our partners.

CIVIL SOCIETY

We work closely with many non-government organisations and charities to deliver our corporate social responsibility commitments and build strong relationships with the communities we serve. Our activity in this area is explained in detail in our Contribution Report, available on our websites later this year, and is summarised on page 36 in under the Communities heading of our Performance.

We work with the media to help communicate messages to our customers through news releases, case studies and social media messaging. This covers a wide range of subjects such as the local impacts of capital investment schemes, environmental and community investment and corporate campaigns, such as Every Drop Counts (see page 21) and Love Your Drain (see page 22).

OWNERS

We are conscious of our duty to act in the best interests of our shareholder and we seek to achieve a fair balance between them and our customers and other stakeholders, including debt investors.

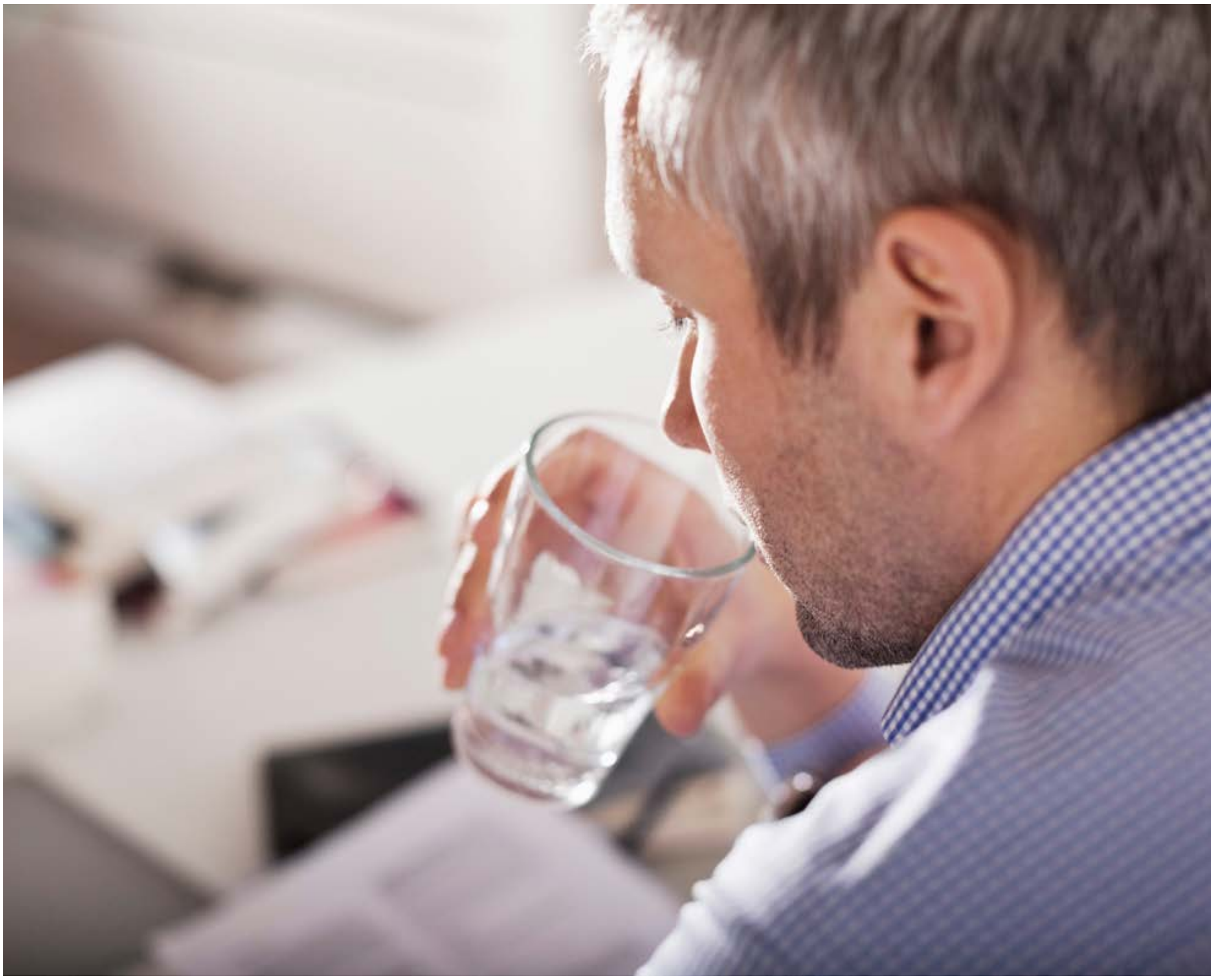
PERFORMANCE REVIEW

In order to measure delivery of the Company business plan and goals, we use a balanced scorecard of KPIs covering the full range of our strategic themes.

We have changed how we present our KPIs this year to report more clearly against the Outcomes, Measures of Success (MoS) and Performance Commitments (PCs) we agreed in the PR14 price review. This is also consistent with our customer-focused reporting in our APR. The top section of the Performance table shows our performance against our Customer and Environment Outcomes, MoS and PCs. The bottom section reports our performance against our internal targets under our Competitiveness, People and Communities Outcomes.

Performance against the KPI targets set in our Financial Statements and APR for the year ended 31 March 2016, which were aligned to Executive Leadership Team (ELT) remuneration, is reported in the Remuneration Committee Report on pages 63 to 73 of the Governance Report.

We are pleased that we have shown year on year improvement across the majority of our KPIs and deliver industry leading performance in many areas, for example, customer service (SIM) and water supply interruptions. The following section provides an update on our progress against our business outcomes and the activity we have carried out over the past year.



ACTUAL PERFORMANCE AGAINST THE KPI TARGETS AND FUTURE TARGETS

SCORECARD MEASURE	UNITS	2015/16 PERFORMANCE	2016/17			2017/18 PC
			PC	PERFORMANCE	ACHIEVED	
Customer						
We provide excellent service and impress our customers						
Ofwat Service Incentive Mechanism (SIM)	score (out of 100)	83.64	90	87.57	No	90
Independent overall customer satisfaction survey	score (out of 10)	8.5	>=8.2	8.5	Yes	>=8.2
Domestic customer satisfaction, net promoter score	score	49	>=32	46	Yes	>=32
Our customers consider the services they receive to be value for money						
NWL independent value for money survey	score (out of 10)	8.2	>=7.9	8.2	Yes	>=7.9
CCWater value for money survey - Water NW	%	77	83	84	Yes	83
CCWater value for money survey - Sewerage NW	%	79	84	84	Yes	84
CCWater value for money survey - Water ESW	%	70	73	67	No	73
We supply clean, clear drinking water that tastes good						
Overall drinking water compliance	%	99.957	>=99.94	99.929	No	100
Discoloured water complaints	no. of complaints	2,923	<=3,508	2,874	Yes	<=2,962
Satisfaction with taste and odour of tap water	no. of complaints	1,225	<=1,069	1,229	No	<=903
We provide a reliable and sufficient supply of water						
Leakage - NW	Ml/day	134.66	<=137	133.82	Yes	<=137
Leakage - ESW	Ml/day	62.42	<=66	68.08	No	<=66
Interruptions to water supply for more than 3 hours	average minutes/ property	03:20	<=06:23	02:26	Yes	<=05:56
Properties experiencing poor water pressure	no. of properties	221	<=216	199	Yes	<=216
Water mains bursts	no. of burst mains	3,819	<=4,586	4,273	Yes	<=4,586

Table continued..

SCORECARD MEASURE	UNITS	2015/16 PERFORMANCE	2016/17			2017/18 PC
			PC	PERFORMANCE	ACHIEVED	
We provide a sewerage service that deals effectively with sewage and heavy rainfall						
Customer						
Properties flooded externally	no. of properties	1,061	<=1,318	839	Yes	<=1,318
Properties flooded internally	no. of properties	143	<=224	119	Yes	<=186
Repeat sewer flooding	no. of properties	82	<=496	46	Yes	<=496
Properties flooded internally (TDS)	no. of properties	219	<=228	215	Yes	<=228
Properties flooded externally (TDS)	no. of properties	2,506	<=2,931	2,730	Yes	<=2,931
Sewer collapses	number	38	<=58	55	Yes	<=58
Sewer collapses (TDS)	number	58	<=84	72	Yes	<=84
Environment						
We help improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife						
Pollution incidents (category 3)	number	156	<=115	102	Yes	<=115
Bathing water quality compliance	no. sufficient	33	>=32	34	Yes	>=32
Sewage treatment works discharge compliance	no. failing works	1	0	1	No	0
We protect and enhance the environment						
Greenhouse gas emissions	ktCO2e	225	<=183	188	No	<=172

SCORECARD MEASURE	UNITS	2015/16 PERFORMANCE	2016/17			2017/18 PC
			TARGET	PERFORMANCE	ACHIEVED	
Competitiveness						
Gearing: net debt to RCV	%	64.5	<=77.5	64.7	Yes	<=77.5
Interest cover	times	4.2	>=2.4	3.8	Yes	>=2.4
People						
Employee engagement score	%	74	>=81	74	No	>=79
Lost time reportable accidents	number	7	<=3	9	No	<=3
Communities						
BITC Platinum Plus	y/n	retained	retain	retained	Yes	retain

CUSTOMER

SERVICE INCENTIVE MECHANISM (SIM)

Ofwat's SIM measures our customers' experience of dealing with us and provides a good indication of how well we are serving those customers who have had a reason to contact us. Our SIM score for 2016/17 has improved significantly to 87.52, from 83.64 in 2015/16, and we are delighted that this places us in joint first place in the industry. We are extremely proud of our performance over the last year and believe that this is a result of the whole business and our supply partners really embracing our Unrivalled Customer Experience Strategy and its core theme of 'Living Water Loving Customers'.

Our customers continue to be at the heart of everything we do and feedback from customers is vital to enable us to improve service. We have implemented real time feedback mechanisms in our call centres and field teams, including our contractors, helping our people to understand what they have been doing well and where improvements need to be made. We've taken action to reflect this feedback including using virtual problem diagnosis by a remote video 'app' to increase our speed of resolution and introducing a single visit team to reduce the number of times we need to visit customers to resolve their issues.

We have been relentless in our drive to achieve industry leading performance in the area of customer service and we are determined to push on from this and become the best service provider our customers' experience.

"We provide excellent service and impress our customers"

UNRIVALLED CUSTOMER EXPERIENCE

We co-created 'Our Unrivalled Customer Experience' Strategy in 2015 with our customers, supply partners and employees and since then we have worked to embed the key principles and success factors across our business. At the end of 2016 our Customer Services team held a 'team talk takeover' which gave all of our employees the opportunity to participate in workshops and share their great customer service stories. This generated over 50 great customer service story videos which we shared on our internal social media network platform 'Yammer'.

"Our customers consider the services they receive to be value for money"

To continue to build trust, we have involved customers through active participation in a number of critical pieces of work that are shaping future service and experience. This has included helping us shape our Information Services Strategy and the design of the new bills that we launched in April 2017. We have also engaged with customers to help us to clearly explain our finances and show where their money is spent, helping us to understand what information they want and how we can best present it.

Through working with our customers to create our strategy for our unrivalled customer experience, we learned that our customers want to know about the great work we do locally and to be made to feel special. One of the ways that we responded to this was our 'Make My Day' initiative. During Customer Service Week in October 2016, we went out into our communities to surprise customers, who had been nominated by friends or family, and specially selected community groups with treats and gifts to 'make their day'. We also took our community engagement hub, 'Flo', to a different location each day and did a special lucky dip for local residents. By the end of this special week, more than 2,000 customers were delighted as we had made their day.

We have continued our investment in our new customer care and billing systems. The first phase was completed on time to support our activities as a wholesaler in the new non-household retail market. We remain on target to deliver an improved customer experience for our household customers, transferring billing to the new system by the end of 2017 and operational contacts in 2018. We are now looking at how to make sure digital experience is also unrivalled, to provide our customers with real choice of how and when they want to contact us, increasing their ability to self-serve and experience a more responsive service.

"Our customers are well informed about the services they receive and the value of water"

CUSTOMER SATISFACTION AND VALUE FOR MONEY

Our aim is to deliver an unrivalled customer experience and, in addition to our industry leading SIM performance, we track various measures of customer satisfaction with the services we provide and the value for money of those services.

Our own customer satisfaction research is carried out quarterly by an independent company and, having achieved our best ever satisfaction score in 2015, we were delighted to maintain this high level in 2016. As an alternative indicator, we use Net Promoter Score to measure customer advocacy, the loyalty that exists between a company and its customers, and are proud of our strong positive score of +46, which ranks us alongside leading UK businesses.

It is important to keep our customers well informed and, at the end of 2016, 94% of our customers told us that they were satisfied that they are supplied with all the information they need to feel informed about the services we provide.

Our customers have also told us that value for money is very important to them, and this is a key area where they would like to be involved in influencing our future plans. We use two surveys to help us assess whether our customers think we offer good value for money.

CCWater (the Consumer Council for Water) carries out research with customers about the value for money of services provided. The results showed levels of satisfaction above the industry average in our NW region for both water and sewerage services, but below average levels in our ESW area, where average bills are higher, due in part to investment to secure supplies in the region by raising Abberton reservoir. We also commission independent surveys which showed increased levels of satisfaction with value for money to 90% in 2016.

SUPPORTING CUSTOMERS IN VULNERABLE CIRCUMSTANCES

We continue to improve our support for customers in vulnerable circumstances and engage with them regularly to understand their needs, building on work carried out with our partners in the free advice sector, such as StepChange and the Money Advice Trust.

Affordability is a real challenge for some customers and, following the promotion of our services to vulnerable customers through our 'Take the first Step' campaign, we now have more than 3,000 customers benefiting from our company funded SupportPLUS tariff.

In conjunction with the Money Advice Trust, we have rolled out a vulnerabilities e-learning course which helps customer-facing employees to identify customers in vulnerable circumstances and provides guidance on how to deal with difficult situations with understanding and empathy. We refer more customers needing support to StepChange than any other water company, and see more than 70% of those customers referred going on to receive a full debt advice service (see case study on page 37).

Our work with Infrastructure North (Northern Gas Networks, Northern PowerGrid, Yorkshire Water and NWL) has also focused on supporting vulnerable customers over the last year. We have worked together on a series of initiatives to jointly promote and align our Priority Services registers to enable customers to sign up should they have specific needs in relation to their utility services, for example home dialysis or requiring braille bills.

RELIABLE WATER SUPPLY

Delivering a reliable supply of water to customers is core to what we do and our industry leading performance on water supply interruptions has continued to improve even further, in spite of an increase in bursts as a result of weather conditions. We have achieved this level of performance through our operational response and providing alternative temporary supplies where appropriate.

We experienced higher leakage than usual in our ESW region throughout the summer and autumn in 2016, after a period of dry weather was followed by heavy rains in the South East of England. This caused ground movement and stress on pipes and resulted in the increased leakage from our water network. An increased focus on finding and fixing leaks is continuing in 2017.

The level of leakage in our NW region reduced slightly, achieving our regulatory performance commitment.

"We provide a reliable and sufficient supply of water"

LONGER TERM RESILIENCE

Building resilience to cope with the challenges of changes in future weather patterns is a key concern expressed by our customers, who want us to be best prepared for the future. Engagement with our customers has highlighted that a reliable supply of clean drinking water is one of the elements of resilience at the forefront of their minds.

The Security of Supply Index (SoSI) measures whether companies have sufficient water resources to meet demand at all times, including periods of high demand during warm, dry weather. Our SoSI score remains at 100% in both NW and ESW.

In order to sustain this, we have continued our industry leading approach to water efficiency and have invited our customers to actively participate in helping us to design and implement solutions to our water resources challenge. This has led to the deployment of 'Every Drop Counts', our largest ever water saving campaign (see case study overleaf).

"We supply clean, clear drinking water that tastes good"

EVERY DROP COUNTS

We have been delivering innovative water efficiency projects since 1997, ensuring that we are widely regarded as the industry leader in water efficiency. Since 1997, over 119,000 school children engaged through an interactive theatre production, and we have carried out over 32,000 household water saving visits.

Every Drop Counts is our largest ever water saving campaign across our northern and southern operating regions. It takes a truly innovative, creative and wide-reaching whole-town approach by offering customers the chance to participate in various water-saving initiatives taking place in the same town at the same time. Using targeted advertising and community based marketing, participation is maximised, helping participants save water, energy and money.

In Every Drop Counts in 2016, we have directly contacted 25,000 domestic customers and 1,700 non domestic customers. 7,794 households are now saving on average 20.5 litres a year and 81 businesses are also saving a total of 10.9 million litres a year, showing what an impact the project has had.

Every Drop Counts goes beyond existing good practice by bringing together the successful initiatives developed over many years and delivering them in one town all at once. Supplemented by an exciting and wide-reaching marketing campaign, the aims are clear; to increase participation, to demonstrate quantifiable water savings and to leave the town as water efficient as possible.

During the campaign, we worked in partnership with environmental charities and community champions to host stands in the local high streets, at supermarkets, shows and festivals to engage our customers in saving water and encouraging them to sign up to take action.

Every aspect of the project is measured. This has enabled us to report real and quantifiable water savings, as opposed to assumed savings. Using meter reads and customer feedback allows detailed statistical analysis, in turn contributing to the industry's evidence base.

Our efforts have seen us win the Water Resource Management Initiative of the year at the 2017 Water Industry Achievement Awards, and be shortlisted at the 2017 Edie Sustainability Awards in the Water Resources Management category.

81
BUSINESSES NOW SAVING

10,900,000
LITRES PER YEAR

WATER QUALITY

The water we supply must meet strict national standards, set by the DWI, to ensure that it is safe to drink and the quality is acceptable to customers, and our overall drinking water compliance remains extremely high at 99.93%. However, this was slightly lower than the previous year with 57 failures from 73,484 tests, though importantly with no risk to public health. Whilst we would expect some variation in performance levels due to samples being taken on a random basis, we are committed to improving water quality and aim to achieve this through a combination of improved water treatment and targeted maintenance of the network.

Another driver of improving water quality performance is our approach to catchment management. We engage with a number of environmental partnerships to deliver catchment improvements in order to help us to improve the quality of rivers, reservoirs and groundwater from which we abstract water for our treatment processes, as well as helping to reduce the risk of flooding and improve biodiversity.

By working in partnership, we are able to pool resources and knowledge to better understand our catchments and work more effectively to address any environmental issues. We currently work with partnerships including the Catchment Partnerships supported under Defra's catchment based approach, the Northumbria Integrated Drainage Partnership (NIDP) and agri-advice partnerships which work closely with Catchment Sensitive Farming, as well as other environmental and community groups and land managers.

CLEAN CLEAR WATER THAT TASTES GOOD

We have been working to reduce discoloured water complaints in our NW area for more than ten years. This year saw the completion of the Main Event, a major programme of large diameter trunk main cleansing on Tyneside. This has culminated in a further reduction in contacts this year. However, we recognise there is still more to do and we are continuing to invest in research and implementing new techniques to manage our networks.

Our drinking water is of a very high quality but occasionally our customers become aware of changes to taste or odour. We carried out bespoke research in 2015 to better understand this issue and have introduced a number of initiatives to improve our service, for example optimising chlorine levels, providing consistent advice to customers and improving our ability to identify and resolve problems caused by internal plumbing issues at customers' properties. The number of taste and odour contacts reduced in 2016 compared to the prior year and is close to industry leading.

"We provide a sewerage service that deals effectively with sewage and heavy rainfall"

SEWER FLOODING

Sewer flooding is one of the worst service failures our customers can experience and reducing this remains one of our highest business priorities. As a result of our investment and customer engagement, we are very pleased to see a continued improvement in our sewer flooding performance with further reductions in the number of properties subject to repeat flooding and internal flooding incidents. External flooding associated with the assets transferred into our ownership in 2011 did increase but remained well within our performance commitment.

As well as continuing to provide capital investment solutions where appropriate, we have further improved our operational processes to make sure that we respond quickly and efficiently to issues on our sewer network. To help with investigations our operational teams are developing new innovative tools to help identify the root cause of issues. One such tool is the porcupine, a spiky tool put in the sewer to help determine the source of items which should not be there.

Our 'Love Your Drain' campaign, spearheaded by the campaign character Dwaine Pipe, continues to grow and to inform customers about the causes of blockages and what can be disposed of down the toilet and sink. Working together with our customers has had a real impact on reducing the number of unnecessary sewer blockages caused by material such as baby wipes, fats, oils and grease. In particular, our innovative work with schools and food outlets is helping to change customer behaviour.

SUSTAINABLE URBAN DRAINAGE SOLUTIONS (SUDS)

As well as addressing immediate flooding issues, we are working in partnership to develop sustainable solutions to build resilience against flood risk, which has been highlighted by our customers as another of their key concerns.

During the year, we continued to develop and improve our industry leading approach to partnership working. The innovative NIDP that we formed with the EA and thirteen Lead Local Flood Authorities in our operating area, continues to strengthen, allowing all partners to take an active approach to integrated drainage issues.

In addition to completing the Brunton Park scheme (see case study on page 24), we completed another partnership project on the Fellgate Estate. Our innovative solution consisted of constructing SuDs solutions throughout the estate, helping to slow the flow of water, and delivering our SuDs for schools programme within the two schools on the same estate, creating swales, ponds, and an outdoor classroom to mitigate flooding risk whilst enhancing the educational experience for the children.

Our approach has been recognised as best practice in the UK Water Industry Research project on partnership working and we received a Water Industry Achievement Award in 2016 for our SuDs for schools and communities project.

We also support Defra's catchment based approach and in 2016 we made the first steps towards aligning the aspirations of the NIDP and the Catchment Partnerships within the region, bringing both partnerships together to work on the River Don catchment. We believe that broadening the objectives and bringing both partnerships together will bring wider benefits to our communities.

In 2016/17 we launched our proactive flood risk reduction campaign, Rainwise. Our aim is to engage with communities, collecting local knowledge and developing innovative effective and sustainable solutions to reduce flood risk. We are targeting communities in drainage areas that may not have flooded in the past but are potentially at risk in the future. This proactive approach aims to find small scale solutions to help reduce flood risk and educate communities giving them the knowledge they need to make informed decisions about their homes and gardens.

SUSTAINABLE URBAN DRAINAGE SOLUTIONS

We have worked extensively with local authority partners, communities and businesses to find mutually acceptable and innovative solutions to the challenge of building resilience against flooding.

Brunton Park is an example of a sustainable drainage scheme which saw a river being diverted to protect homes on Tyneside from flooding. Completed in August 2016, the scheme has reduced the flood risk to more than 100 homes from three sources of flooding, including our surface and foul sewer networks and the River Ouseburn.

Working in partnership with the EA, sustainable solutions included the installation of 380 metres of new river channel to divert the River Ouseburn away from the Brunton Park estate and a storage basin created using the old section of the river course. Almost two kilometres of new sewer, 600 metres of flood defence walls and an underground storage tank were also constructed.

As well as reducing flood risk, the scheme has delivered environmental benefits including the management of surface water in the natural environment and the creation of increased wetland habitat for wildlife, an area that the local community can enjoy.

The community have also been engaged in other ways. The route runs along the edge of the City of Newcastle golf course and a professional designer was commissioned to create an improved course incorporating the new river channel. Two new feature holes were created, something that the club and its local golfers are exceptionally pleased with.

Within the housing estate, the works required the demolition and replacement of the play area. On completion of the work a new playground was co-created following extensive consultation with residents, the Parish Council and Newcastle City Council, providing a lasting legacy for the community.

The project won the Sustainable Drainage and Flood Management category at the Water Industry Achievement Awards 2017 and the model has been so successful that similar schemes have been subsequently implemented in South Tyneside, North Tyneside and Northumberland, each time using the learning and experience from our customers.

"We deliver water and sewerage services that meet the needs of current and future generations in a changing world"

LEADING ASSET MANAGEMENT

We adopt an integrated approach to managing our assets, which means finding the right balance between operational and long term maintenance and investing in new assets at the right time, in the interests of current and future customers. We have company-wide accreditation to ISO 55001 Asset Management, demonstrating that we follow best practice in the long term management of our assets.

We use the concept of Asset Health to assess the effectiveness of our long term stewardship of our assets, based on two baskets of measures, for water and wastewater. All bar one of our measures in each basket met or exceeded their PC in 2016/17, with only overall drinking water compliance and sewage treatment works discharge compliance failing narrowly to achieve their PC. More detail on our asset health performance is available in our APR.

EDUCATION

We believe that education is key to developing a sustainable planet and we have developed 'Water & so much more', an innovative new communication tool using ecosystem services, which shows our communities the benefits they receive through the company managing its land for biodiversity. This maps our estates into main areas of management or influence, such as local community, access and recreation, wetland and woodland. Users can access an ecosystem service table for each area, providing information on our current management practices and explaining the benefits. This is the first time ecosystem services have been used in this way within the water industry.

Helping our customers to understand where their water comes from, how it is treated, reaches their homes, and ultimately is returned safely to the environment, starts at an early age and we are committed to educating our customers of the future. We have created a new educational resource for children, a gang of super heroes known as the 'Super Splash Heroes' who help young people to learn about water in the environment, water efficiency and water for health. Accessed through our web site the new on line resource offers educational materials for schools and supports fun learning for children and families with online activities, worksheets, videos and even information about the varied range of exciting careers available within the water industry.

ENVIRONMENT

"We help to improve the quality of rivers and coastal waters for the benefit of people, the environment and wildlife"

We recognise the impact our operations and activities have on the environment and we aim to protect and improve the environment for everyone's benefit. Our carbon management plan is helping to reduce our carbon footprint and we aim to adopt good environmental practice in all aspects of our activity.

SEWAGE TREATMENT WORKS DISCHARGE COMPLIANCE

Our performance on sewage treatment compliance has been excellent for a number of years, with no failures for seven years before a single failure in each of the last two years. Our aim remains to have zero failures, which is a challenging target. The standards we must comply with are also continually tightening and we are making a significant investment in our assets to reduce the amount of phosphorus being discharged and contribute to improving river water quality in the NW region.

POLLUTION INCIDENTS

We manage and maintain a network of almost 30,000km of sewers across the NW region. Problems with our sewerage system can result in untreated sewage escaping from our sewers and causing environmental damage. While we make every effort to reduce the risk of this happening, a small number of pollution incidents still occur.

The number of category 3 pollution incidents, which have minor environmental impact, reduced significantly in the year, supported by improvements in our pollution management approach. However, we were disappointed that the number of more serious category 1 and 2 pollution incidents increased to 9 in 2016, from 5 in 2015. We continue to work closely with the Environment Agency (EA) to identify lessons that can be learned to make sure serious incidents aren't repeated.

In relation to one of these incidents, at West Wylam sewage pumping station in February 2015, we have entered into an enforcement undertaking with the EA. This will result in us contributing the sum of £390,000 to a number of local environmental charities including River Trusts for the Tyne, Northumberland, Wear and Tees and the Groundwork 'Land of Oak and Iron' project.

Our target is to have no serious pollution incidents and to reduce category 3 incidents to very low numbers. To achieve this we have developed an extensive programme of work including activities and investment that targets specific assets (e.g. sewage pumping stations and combined sewer overflows), community engagement through our Water Rangers initiative, and the development of early warning systems to highlight potential problems.

"We protect and enhance the environment in delivering our services, leading by example"

WATER RANGERS

Our award-winning Water Rangers scheme, launched in 2014, involves volunteers in monitoring public access routes next to streams, rivers, becks, burns and bathing waters across the North East which are prone to pollution. After completing weekly or fortnightly patrols, Water Rangers report on the condition of the watercourse so that any potential pollution can be dealt with quickly. They are a critical 'early warning' system in our endeavours to protect and enhance our environment.

Volunteers receive thorough environmental training about what to look out for when monitoring watercourses and their knowledge of the local environment and ability to spot changes and trends is invaluable.

By the end of February 2017, a total of 2,792 patrols had been carried out with 143 issues reported. Eight of these were then self-reported to the EA.

Originally starting with 32 routes, the scheme has expanded in recent months to 55 routes patrolled by a team of 67 Water Rangers. Three quarters of the original volunteers are still with the scheme and mood surveys with the Water Rangers result in high Net Promoter Scores, reaching +85. They are a great example of how our customers are participating in our efforts to reduce pollution in our local areas and helping to shape and deliver tangible solutions.

55 ROUTES

PATROLLED BY A TEAM OF 67 WATER RANGERS

BATHING WATER QUALITY COMPLIANCE

We have a key role to play in maintaining the quality of our regions' bathing waters and we are proud that our region has the highest percentage of bathing waters classed as Good or better in England. All 34 designated bathing waters in our region met the minimum standard of Sufficient or better, with 27 classed as Excellent and a further six as Good.

We are working in partnership with the EA, Scottish Environment Protection Agency and Northumberland County Council to further improve bathing water quality at Spittal beach, at Berwick-upon-Tweed, which was classed as Sufficient standard. We are also carrying out investigations at bathing waters near the Tees Estuary, to see how we could further improve quality.

ENERGY EFFICIENCY

Our carbon management plan has the aim of reducing our greenhouse gas (GHG) emissions by 35% by 2020 against a 2008 baseline. We remain on track to achieve this target with emissions reducing by 17% compared to the previous year and down by 38% compared to the baseline, of which 30% is driven by our own efforts and 8% is the result of a lower emissions factor for grid electricity. This performance is explained in more detail on page 74 of the Directors' Report. Our energy strategy has four pillars: renewable generation, energy efficiency, smart energy, and efficient procurement.

In respect of renewable energy, we remain the first and only wastewater company in the UK to use 100% of the sludge remaining after sewage treatment to produce renewable energy at two thermal hydrolysis advanced anaerobic digestion (AAD) plants. At one of these plants, we also clean and transform the biogas from the AAD process into biomethane for injection to the gas distribution network. We are continuing to explore other opportunities with partners, particularly in the areas of hydro, wind and solar.

In terms of reducing energy usage, we use a number of approaches, including site energy audits, data analytics, trigger management and investing in energy efficient assets, to drive down our underlying consumption, accepting that our overall usage can be volatile, depending upon levels of rainfall and pumping requirements. Our smart energy approach is focused on managing our operations to reduce energy use during times of peak nationwide consumption. This helps to reduce demand on the grid, and also reduce our costs.

COMPETITIVENESS

The financial performance of the Company is detailed in the financial performance and structure section later in this report.

INNOVATION

Our innovation strategy sets out how we enable and empower our people to drive our continuing success. We focus on innovating with a purpose to achieve our priorities, whether it is to improve water quality, reduce sewer flooding, tackle pollution incidents or deliver an unrivalled customer experience. We have adopted the concept of 'design sprints', harnessing the creative potential of our people to rapidly develop solutions to business problems (see case study on page 30).

"We are an efficient and innovative company"

Our innovation strategy is also shaping how we interact with our supply chain, helping us to meet the challenges of delivering our capital investment programme as efficiently and effectively as possible. This new approach is now firmly embedded, including the co-location of our people with our framework partners' staff and the establishment of joint working groups. We are also now including our supply chain partners in our process for assessing and adopting new technology, providing a route into our business for supplier-led innovations.

In July 2017 we will host our first ever Innovation Festival, which will see some major national and global companies working together to celebrate creativity, gain inspiration from others and have fun. The work will focus on six big challenges we face, such as how can we reduce flooding and what can businesses do to improve the environment in the north east. This will take place in a true festival environment that will also feature live comedy and music, inspirational talks and an open air cinema giving the feeling of a summer festival.

"Our finances are sound, stable and achieve a fair balance between customers and investors"

RESEARCH AND TECHNOLOGY

Alongside engaging our people, suppliers and customers in innovative thinking, we continue to invest in research and technology development, working with academic partners to deliver projects that will help us to achieve our current and future performance commitments. Notable successes this year include:

- The establishment of Europe's only replicated biological wastewater research pilot facility on one of our sewage treatment works, in collaboration with Newcastle University; our collaboration is shortlisted in the Business Partnership category of the Guardian's University Awards;
- University of Sheffield research into the prediction of discoloured water in distribution systems, contributing to reducing discoloured water contacts and a 90% reduction in the cost of cleaning some water mains;
- An industry-leading pilot to incorporate flow cytometry, an innovative particle characterisation technique used in medicine, into our drinking water risk assessment and reporting process; and
- A mobile customer engagement hub, designed with support from University of Northumbria.

WORKING SMARTER

Working Smarter is our ongoing campaign which engages people across the Company to identify and exploit opportunities for realising capital and operational efficiencies and creating long-term sustainable benefits. We have a network of Working Smarter advocates and a suite of tools and materials to help people develop and deliver their ideas. In October 2016 we launched IdeaBase, an ideas management platform, developed to allow people to log ideas or solutions and track their progress through approval, implementation and benefit validation. Since its launch, nearly 350 ideas have been submitted.

INNOVATION SPRINTS

As part of our strategic approach to innovation, we have been targeting areas where a step change in performance is required and have applied an innovative 'sprint' approach to enable us to push the boundaries of what is possible, to think big and to make rapid progress.

The real difference between a design sprint and day-to-day business is the speed and focus of a sprint. It would normally take many weeks to define the problem, generate ideas, choose the most promising ideas, prototype them and then validate their impact, however on our sprints these steps are conducted within five or fewer days.

We have seen some really positive outputs of our sprints which have looked at many areas including improving customer service, reducing pollution and delivering efficiencies. We have rapidly implemented new ideas and have seen many benefits some of which include:

- An improved customer house moving journey which keeps the customer up to date with state of their journey, ensuing our customers have the information they need without having to contact us;
- A new one-way video technology which enables rapid and remote inspection of issues reported to us, enabling quicker resolution and avoiding the need for costly and time consuming travel;
- Using data analytics on our sewage pumping station data to predict when possible issues are about to occur, preventing potential pollution;
- A new streamlined and efficient recruitment process, which enables us to reach out and attract the best candidates into our business;
- Reducing energy use, and cost, at a major water treatment works; and
- Identifying concepts and solutions for locating and mapping drains and small sewers.

PEOPLE

EMPLOYEE SATISFACTION AND ENGAGEMENT

We aspire for everyone to have a great experience at work and feel proud to work for the Company every day. Our most recent annual survey told us that 71% of our people believe that NWL is a great place to work, 77% would recommend working here to others and 84% enjoy their job.

We engage with our employees through our Employee Relations Framework and through a range of communication channels including director roadshows, structured Team Talk briefings every two months, our weekly H2info ebulletin, and digital tools such as our intranet and Yammer. Last year, our CEO, Heidi Mottram, held 62 roadshow sessions with our employees, after which 79% said they were 'more informed' about the part they play in our journey to national leader. Each directorate has a local engagement action plan to make sure we can continue to make NWL a great place to work for all of our people.

Our employee awards scheme, known as ViVa (Vision and Values), is now in its sixth year and more than 170 employees nominated their teams and colleagues to be recognised for living our company values.

"Our people are talented, committed and inspired to deliver great services to customers"

During the year, we have refreshed our approach to employee engagement and introduced our Great Place to Work Programme focusing on employee voice, leadership development, our values and behaviours, inclusion and health and wellbeing. We will develop the strategy following feedback from all of our people at our 2017 roadshows and through our annual employee survey.

We continue to be accredited as a Living Wage Employer with the Living Wage Foundation, which means that every employee in the Company earns at least the Living Wage, an hourly rate set independently and calculated according to the basic cost of living for the UK.

SKILLS DEVELOPMENT

The EU Skills Partnership has launched the sector's first ever Workforce Renewal and Skills Strategy to help find 221,000 new recruits to the industry by 2027. With 26 partners from across the energy and utilities sector, we're aiming to tackle future skills shortages to ensure we can continue to give customers the service they expect and deserve.

We are working with partners and a range of other organisations to deliver apprenticeships and other routes into the sector. We also work in schools, with around 8,000 young people each year, to educate them about water and also to enthuse them about our industry, so they see the varied and exciting careers available within the utilities sector.

We currently have ten Higher Degree Apprentices earning as they work towards their BSc (Hons) Digital and Technology Solutions degree, delivered in partnership with the University of Sunderland. Working with our team, the apprentices are helping to develop real applications and projects that will enhance the experiences of employees and customers alike.

We recognise the importance of effective leadership to empower our people to take ownership and responsibility for delivering an unrivalled experience for our customers. We have introduced emotional intelligence 360° feedback for our Senior Leaders and are continuing their development through our Extraordinary Leadership Programme. We've recently worked with colleagues across the Company to identify how our behaviour can support our values and aspirations and help us ultimately deliver our vision of being national leader.

"Our people act in line with our values"

SKILLS

Students and academics at some of the UK's leading universities are helping us to get answers to business problems and develop new knowledge that will help us to keep at the forefront of our industry.

Over the last two decades, we have built a network that includes universities across our operating regions: Newcastle, Northumbria, Durham, Sunderland, Teesside, UEA and Essex. They join other leading institutions from across the UK including; the Cranfield University-led doctoral training centre, STREAM, Sheffield, Exeter, Cardiff, Strathclyde, Birmingham universities and Imperial College London.

Much of our collaborative work is funded by the Engineering and Physical Sciences Research Council and the Natural Environment Research Council, in the form of post-doctoral research, for example to predict and reduce incidences of discoloured water affecting our customers. It also includes supporting postgraduate research across a broad range of science and engineering disciplines.

We currently sponsor around 30 students through their postgraduate research and the findings that come back have enhanced our understanding of areas including water and wastewater treatment processes. This includes knowledge on how to recover energy and other resources, improving water quality for customers and the environment, how to sustainably reduce flood risk and how to engage more effectively with our customers and other stakeholders.

For the students, the opportunity and challenge is to approach a piece of research that has requirements of both an academic and an industrial nature.

"We are seen as a great place to work"

DIVERSITY AND EQUAL OPPORTUNITIES

As a company, we recognise the value and importance of diversity and inclusion in our workforce. Our aim is to go beyond compliance for those elements of diversity that are protected by law, and instead to support all of our people to be the best that they can be in an environment that values and capitalises on everyone's contribution. We are working actively in partnership with other organisations, for example, supporting the launch of a new group aimed at improving gender balance and promoting diversity in science and engineering in the NW area.

Our equal opportunity policy seeks to ensure that all our current employees and potential employees are treated with respect. We welcome job applications from all parts of the community and it is our intention that all job applicants and employees are treated equally, regardless of their age, ability, marital or partnership status, race, religion or belief, gender or sexual orientation.

We welcome employment applications from people with disabilities and, where existing employees develop disabilities, they are supported to remain in employment, wherever practicable, by providing appropriate adjustments to their roles and/or effective redeployments. Occupational health physicians assist this process with professional medical advice.

GENDER DIVERSITY AT 31 MARCH 2017

	Female	Male
Board	2	10
ELT	5	5
Full company	1,013	2,013

GENDER PAY GAP REPORT

We set out our Gender Pay Gap figures as at April 2017 using the company data and the parameters set out by legislation. The data represents 3,020 employees who work in various roles across a national footprint.

We are committed to the principle of equality of opportunity and equal treatment for all of our employees. The data reported below demonstrates a positive picture of pay equality in the Company, with both the mean and median gender pay gaps being below the Office of National Statistics (ONS) average and our median gender bonus gap being zero. This is informed by the number of females in very senior roles.

GENDER PAY DATA

NAME	%	ONS AVG %
Mean gender pay gap	9.8	17.5
Median gender pay gap	17.2	19.2
Mean gender bonus gap	-66.4	
Median gender bonus gap	0.0	
Proportion of females paid a bonus	20.6	
Proportion of males paid a bonus	23.6	

PAY QUARTILES BY GENDER

QUARTILE BANDS	DESCRIPTION	FEMALE	MALE	TOTAL
Band A	All employees whose standard hourly rate places them at or below the lower quartile.	408 (54.0%)	347 (46.0%)	755
Band B	All employees whose standard hourly rate places them at or below median but above the lower quartile	235 (31.1%)	520 (68.9%)	755
Band C	All employees whose standard hourly rate places them above median but at or below the upper quartile	163 (21.6%)	592 (78.4%)	755
Band D	All employees whose standard hourly rate places them above the upper quartile	207 (27.4%)	548 (72.6%)	755
Total		**1,013**	**2,007**	**3,020**

We have worked with our Directors, senior leaders and our people over several years to promote equality, diversity and inclusion resulting in a number of positive activities, including:

- promoting inclusion and diversity from the top of the organisation, from our female CEO and ELT (where there is currently a 50:50 gender split);
- training our managers to raise awareness of unconscious bias and utilising our employee ambassadors to promote our principles which support and enable an environment where fairness and equality exist;
- undertaking job evaluation in line with a globally recognised framework and reviewing pay grades to ensure a fair structure;
- becoming a signatory of the Women in Science and Engineering (WISE) 10-steps programme and developing the WISE hub for the north east;
- operating a recruitment process which is geared towards transparency, diversity and equality by actively encouraging females to apply for roles, challenging search agencies for gender-balanced shortlists and reviewing job roles to ensure they are attractive to women;
- conducting pay and benefits benchmarking exercises and salary reviews to ensure we are in line with market trends; and
- conducting equal pay reporting.

We are confident that our relatively small gender pay gap does not stem from paying men and women differently for the same or equivalent work, rather it the result of differences in the roles held by men and women within the organisation and the different market salaries that these roles attract.

We believe our results are positive when compared to others who have published their figures and we recognise that the results indicate that there is opportunity to improve. We are committed to promoting inclusivity, attracting, developing and retaining diverse talent and paying fairly based on job role and performance.

OUR WORKPLACES ARE HEALTHY AND SAFE

HEALTH AND SAFETY

It is our aspiration and ethical responsibility to make sure all our employees and supply chain partners go home safely every day. During 2016 we maintained our high safety performance keeping us within the top quartile of water companies. We are certified under OHSAS 18001 Occupational Health and Safety Systems and received a gold medal award from the Royal Society for the Prevention of Accidents (RoSPA) for the fifth consecutive year. The RoSPA Gold Award recognises organisations which have achieved a high level of performance and demonstrated well developed occupational H&S management systems and culture.

We are proud of our record of maintaining a healthy and safe workplace, and we are working hard to improve this even further. We want to create and maintain a great safety culture and over the last year we have put a significant amount of effort into further improving behavioural safety, using tools such as 'safety shares', stories demonstrating good practice or an opportunity to learn, 'spot its' to encourage reporting of health and safety issues and concerns by employees, and regular communication of key health and safety messages. This commitment to developing and maintaining this strong behavioural safety culture is clearly demonstrated by our Executive Leadership Team who go out regularly to meet employees in their workplace environments to discuss health and safety.

WELLBEING

We are committed to providing an environment where people can maintain good physical and mental health and make informed lifestyle choices. Our holistic health and wellbeing strategy focuses on providing support when people are unwell and information and advice to enable people to maintain a healthy lifestyle. We have undertaken a recent review of our wellbeing services to ensure we are providing the best possible support to our people through our occupational health, physiotherapy and employee assistance programmes.

Our 'Live Well, Work Well, Be Well' programme includes support from a network of health and wellbeing champions across the business and a calendar of health promotion campaigns throughout the year, such as Mental Health Awareness Week, Carers Week and No Smoking Day, signposting to sources of information internally and externally. In 2017 we launched the 'NWG Wellbeing Challenges', the first of which were four week Weight loss and Energy4Life challenges to encourage people to develop and maintain healthy habits.

To demonstrate our commitment to improving mental health and help reduce the stigma and discrimination around mental health, in 2016 we signed the Time to Change pledge and commenced training in mental health awareness for all of our managers. We also provide building emotional resilience workshops to all of our people across the business, offering bespoke workshops to support people through change.

COMMUNITIES

We are dedicated to building strong relationships with the communities we serve and we ensure that corporate responsibility is embedded in the business. In 2016/17 we continued our commitment that at least 1% of our pre-tax profits were re-invested in our communities through dedicating expertise, employee time, money and facilities.

EMPLOYEE VOLUNTEERING

We encourage our employees to support community and charitable organisations through our employee volunteering scheme, Just an Hour. This scheme allows employees to use their wealth of knowledge, skills and expertise to impact positively on education, the environment and the general wellbeing of the community. Each of our employees is given the opportunity to take a minimum of 15 working hours a year to support community initiatives.

Since the launch of Just an Hour in 2002, our employees have committed more than 100,000 hours in support of the communities we serve and more than half of our workforce are actively engaged in the programme, supporting 836 organisations in 2016/17.

"We are proud to contribute to the success of local communities"

PARTNERSHIPS

Our work with partners in our communities is based on our Partnerships Strategy, which gives a clear direction to make sure we are focusing our efforts on the things that our customers have told us are most important to them. Our Partnership Strategy puts working with partners to deliver common goals at the heart of our community activity.

We work with partners across sectors at a range of levels, from making sure we provide effective grassroots support to a large number of organisations in our community, to a small number of larger strategic flagship partners co-delivering with us in line with our vision and values. In 2016/17, we continued many successful and long standing partnerships as well as working with new partners to work together towards common goals, supporting 1,273 organisations in total.

IMPACT IN 2016/17

Our contribution in 2016/17 will be detailed in our Contribution Report, but some of the highlights are shown below.

- **Advising customers in financial difficulties** - through our strategic partnership with the debt charity StepChange, 3,918 customers received advice and support to help manage debt (see case study overleaf).
- **Educational partners** - in 2016/17 we engaged with nearly 8,000 young people in programmes to support their learning, development and readiness for work.
- **Organisations based on our sites** - we are proud to host a number of partners on our sites, enabling these special places to be enjoyed by the community. In 2016/17 we welcomed more than 560,000 visitors to these sites.
- **Memberships** - we work with a number of business and trade bodies across our region and nationally, to support engagement with our customers and on significant areas of policy that impact on the wellbeing of the areas we serve.
- **Cultural, environmental and historic memberships** - we hold memberships with a number or arts, historic and cultural organisations, supporting the important work of these organisations.
- **Water Rangers** – our team of volunteers completed 1,137 patrols of sensitive watercourses across the NW region to help protect our rivers.
- **Bottled tap water** - we supplied 95,000 bottles of top quality tap water to 220 charities and not for profit groups for use at community events.
- **Natural environment** - our Branch Out fund helps to deliver projects that benefit the natural environment and local communities. In 2016/17, through Branch Out, we supported a variety of partners with 15 projects providing close to £60,000 in funding, unlocking more than £375,000 in match funding.
- **WaterAid** - through our fundraising in the year for the international charity WaterAid, 13,600 people in developing countries were given access to clean water and sanitation, as well as hygiene education.
- **Community Foundations** - we donated £115,000 income from endowment funds to support 24 community and charitable activities across our areas of supply, advised by four community foundations.

STEPCHANGE

We recognise that sometimes life's ups and downs mean that some customers may find themselves in challenging financial situations. As a business that has some of the most deprived areas in the UK within our operating areas, it's important that we understand the difficulties our customers can face and that we find ways to help.

The key to providing the best support has been to find a community partner that genuinely knows how to help people experiencing financial difficulties. Three years ago, in an industry first, we teamed up with the StepChange Debt Charity to form a partnership to offer customers access to free, confidential debt advice and support.

As the UK's largest debt charity, StepChange is a natural partner to entrust with such important and often sensitive matters for our customers.

In 2016 nearly 4,000 of our customers received advice and support to help manage debt from StepChange, 45% more than 2015. These referrals allow us to understand better each customer's financial situation and create an opportunity, and the time, for them to work with the charity to put together an action plan.

StepChange gives advice on a range of issues, from debt to bankruptcy, and even has an online benefits calendar on its website.

The partnership runs alongside a range of support available directly through our team, giving customers a number of ways to pay their bills. This includes; monthly instalments and budget plans, to help customers spread the cost of our services, short term payment plans and even payment holidays for customers who have a break in income.

In times where a whole community is struggling, such as in the collapse of the steel works business in Redcar during 2016, StepChange have been able to assist us and our customers to quickly put in place support to prevent a bad situation becoming much worse.

REPUTATION

TRUST

Each year CCWater asks customers for their views about the services they receive from their water and sewerage company. We are proud that, for the third year running, the survey has named us as the most trusted water company. In 2016 we were also listed, for the seventh consecutive year, as one of the world's most ethical companies by Ethisphere. We remain the only water and sewerage company in the world to be included on this prestigious list.

We have robust governance and assurance arrangements in place to ensure that the information we publish is accurate, clear and transparent; in doing so we aim to continue to build trust and confidence with our customers and stakeholders. Our Final Assurance Plan is published in full on our websites each year and this year we have also published our Assurance Summary, describing how we have carried out this Assurance Plan over the course of the year.

Our assurance framework builds upon our integrated management system. We have company-wide accreditation to: ISO 9001 Quality Management; ISO 14001 Environmental Management; OHSAS 18001 Occupational Health & Safety Management; and ISO 55001 Asset Management. In addition our sampling and laboratory analysis are accredited to ISO 17025. We are working towards achieving company-wide accreditation to ISO 22301 Business Continuity Management and would be the first water company to achieve this.

"We are a company that customers can trust"

OUR ROLE IN THE REGIONS WE SERVE

We understand that as a large local business, supplier of essential services and a major employer, we have a responsibility and important role to play in the regions that we operate in. We work with a number of business, consumer and charitable bodies, across our regions and nationally, that have a significant influence on policy that impacts on the wellbeing of the areas we serve.

We continue to take an active role in Business in the Community, the Prince's Responsible Business Network, which works to tackle a wide range of issues that are essential to building a fairer society and a more sustainable future. Our contribution includes helping to take forward the BITC's national Water Task Force, which is working to address some of the most pressing water challenges facing the UK.

Our CEO, Heidi Mottram, was appointed as North East Regional Ambassador for HRH The Prince of Wales in 2016. The Prince's Ambassadors are chosen for their leadership in transforming their own businesses and empowering other organisations to take action. Heidi is leading on two key areas: business resilience, with a particular focus on water resources and flooding, and supporting the rural economy. Heidi is also playing an extensive role helping to develop the regional economy more generally as Vice Chair of the North East Local Enterprise Partnership (LEP) and with her role on the national board of the CBI.

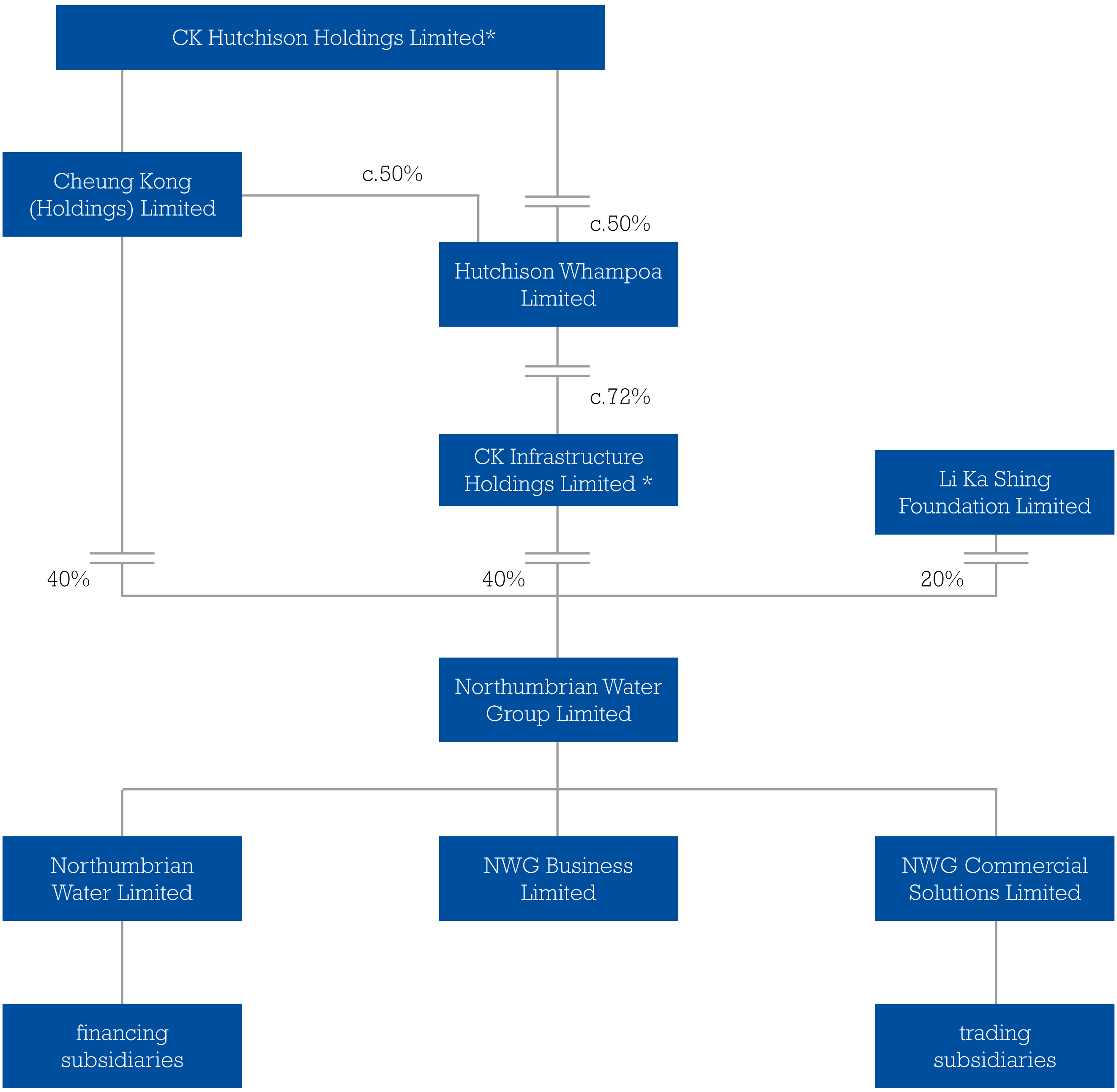
FINANCIAL PERFORMANCE AND STRUCTURE

GROUP STRUCTURE

NWL is a wholly owned subsidiary of NWGL. NWGL has two other direct subsidiaries, NWG Commercial Solutions Limited, which acts as a holding company for other non-regulated trading companies, and NWGB, which carries out retail activities in England and Scotland and to which NWL's non-household customer base transferred at the opening of the market in April 2017 (except for customers who pre-registered to switch retailer upon the market opening).

In the directors' opinion, CKHH is the ultimate parent undertaking and controlling party of NWGL and, therefore, NWL. The chart below shows the structure of the Northumbrian Water Group (the Group) up to CKHH.

The chart shows the principal intermediate holding companies, which are wholly owned unless otherwise shown.



* Companies listed on the Hong Kong Stock Exchange

FINANCIAL PERFORMANCE

The financial KPIs we report in our balanced scorecard on page 16 reflect the financial covenant underpinning our committed bank facilities, which are reported to each Board meeting. These KPIs remained better than the target for the year.

The Company's income statement, statement of comprehensive income, balance sheet and statement of changes in equity are set out on pages 78 to 81 The Financial Statements have been prepared on an historical cost basis in accordance with FRS 101, reflecting IFRS with reduced disclosures. The key accounting policies are summarised in note 1 to the Financial Statements on pages 82 to 86 and have been applied consistently to current and preceding period information.

Operating profit for the year ended 31 March 2017 includes an exceptional credit of £10.7m relating to the settlement of an outstanding appeal on business rates. Operating profit for the prior year included an exceptional pension curtailment of £38.9m. These items are explained in more detail in note 4. After adjusting for these exceptional items, the underlying operating profit for the current year is £12.4m (3.7%) higher than underlying performance in the previous year.

Revenue was £821.6m for the year ended 31 March 2017 (31 March 2016: £805.5m). This reflects an increase in wholesale charges, set in line with the revenue allowance from the PR14 FD, which increased by a 'K factor' of 0.8%, plus RPI of 1.1%.

Operating costs, including capital maintenance costs, for the year ended 31 March 2017 were £464.7m (31 March 2016: £432.8m), including the exceptional items described above. Underlying costs, excluding exceptional items, have increased slightly in the year, by £3.7m (0.8%). This reflects general inflationary pressures, including staff costs, some restructuring costs and increased depreciation resulting from our capital investment programme. These have been mostly offset by reductions in our bad debt charge, due to high costs in the prior year from the closure of a large customer and a review of our provisioning model, lower abstraction costs resulting from a reduction in licenced volumes which are no longer required, and cost efficiencies from our Working Smarter programme.

Net interest payable was £136.6m in the year ended 31 March 2017 (31 March 2016: £106.3m). The increase of £30.3m was caused by adverse mark to market movements on the fair value of financial instruments, the impact of higher RPI on index-linked debt accretion, acceleration of interest charges related to the buy back of £120m of bonds due to mature in October 2017, and a reduction in amounts due from Group companies resulting from the reassignment of a loan to NWGL in March 2016 at which date the interest rate was changed from fixed to variable rate linked to LIBOR.

Profit on ordinary activities before taxation for the year ended 31 March 2017 was £220.3m (31 March 2016: £266.4m). The current tax charge for the year ended 31 March 2017 was £38.3m (31 March 2016: £33.3m). The increase in the charge reflected non-allowable losses on derivatives, reduced pension deductions and the one-off nature of deductions in the prior year relating to the adoption of FRS101. Deferred tax for the year ended 31 March 2017 was a credit of £19.3m (31 March 2016: credit of £29.8m). The reduction in the credit reflected a lower restatement of deferred tax liabilities than in the prior year due to a smaller cut in future corporation tax rates, offset by the impact of derivatives and pensions. Further details of the net tax charge are provided in note 8 to the financial statements. Profit for the year ended 31 March 2017 was £201.3m (31 March 2016: £262.9m).

The Directors do not recommend payment of a final ordinary dividend (31 March 2016: £nil). Total dividends paid in the year ended 31 March 2017 were £212.5m (31 March 2016: £211.0m). The dividend policy is explained in note 9 to the Financial Statements.

CAPITAL INVESTMENT

Total fixed asset additions in the year ended 31 March 2017 were £225.2m (31 March 2016: £223.2m); £190.5m net of capital contributions (31 March 2016: £190.6m). Around £148m of this investment related to the maintenance of our asset base to ensure the continued provision of sustainable water and wastewater services in the areas we serve. In addition we have continued to enhance our asset base, in particular to reduce the risk of sewer flooding and to support new development activity in our areas of operation.

Our ONCE programme, to transform our billing and customer contact systems for household customers and for interacting with the NHH retail market in our capacity as a wholesaler, progressed well in the year. We also continued work on two of our most significant AMP6 projects, the upgrade of Horsley water treatment works, which serves Newcastle, and addressing sewage spills at Whitburn, which remain on target for timely delivery.

CAPITAL STRUCTURE AND LIQUIDITY

The Company's long term debt structure remained largely unchanged with 65% fixed at an average rate of 4.96%, 30% index linked at an average real rate of 1.42% and 5% on a variable rate basis. The blended average nominal rate for the Company for the year ended 31 March 2017 was 4.52% (31 March 2016: 4.39%), the slight increase relating to higher indexation on index linked debt.

In September 2015, the European Investment Bank (EIB) approved a new £250m loan facility, to support our AMP6 capital plan. An initial £150m tranche was drawn in October 2015. The remaining £100m tranche was drawn after the balance sheet date in June 2017.

In October 2016, through our finance subsidiary Northumbrian Water Finance plc (NWF), we issued £300m Guaranteed Eurobonds, with an annual coupon of 1.625%, maturing October 2026. NWL guaranteed the issue and received the issue proceeds by way of an inter-company loan. The proceeds were partially used to buy back £120m of bonds due to mature in October 2017. We are currently developing our strategy for the refinancing of the remaining £180m bond, maturing in October 2017.

We have a committed five year bank facility in place to maintain general liquidity, with a total value of £350m maturing in 2019. This was undrawn at 31 March 2017.

Gearing increased marginally from 64.5% to 64.7%, with net debt and RCV both growing at broadly the same rate, and remains well within target. Interest cover fell slightly, due to the increased finance charges, but also remains comfortably better than target. The Company retains strong investment grade credit ratings of BBB+ (stable outlook) from Standard & Poor's (S&P) and Baa1 (negative outlook) from Moody's. The difference in outlook reflects Moody's view on the gearing level of our parent company, NWGL, whilst recognising the strength of the regulatory ring-fence. We report on our financial resilience in our viability statement on page 75.

TREASURY POLICIES

The Board is responsible for the financing strategy of the Company which is determined within treasury policies set by NWGL. The treasury policies set out how the risks associated with treasury activities are managed, which are summarised below. On occasion, derivatives are used as part of this process, but the treasury policy prohibits their use for speculation.

Funding risk

The level of capital expenditure which NWL is obliged to incur is such that we cannot be wholly cash financed by internally generated sources. As a result, we must rely upon raising additional finance on a regular basis, to be principally used to fund the long term assets required by the regulated business. In order to raise this finance efficiently, the Board's aim is to retain our strong investment grade credit rating at BBB+ (Standard & Poor's) and Baa1 (Moody's). A reduction in the credit rating would likely restrict future sources of funding, increase the associated cost of new borrowing and prompt discussions with the EIB about the existing facilities in place.

Liquidity risk

The Company's policy is to have available standby committed bank borrowing facilities with a value of no less than £50m and with a bank agreement availability period of no less than three months. At 31 March 2017, NWL had £350m (31 March 2016: £350m) of undrawn bank facilities, provided by a group of five key relationship banks, which mature in 2019.

Interest rate risk

The Company finances its operations through a mixture of retained profits and borrowings. It borrows at both fixed and variable rates of interest and, on occasion, uses derivatives to generate the desired interest profile and to manage its exposure to interest rate fluctuations. The Company's policy is to keep a minimum 50% of its borrowings at fixed rates of interest. At 31 March 2017, 65% (31 March 2016: 62%) of the borrowings of the Company were at fixed rates of interest. Index linked borrowings are treated as variable rate debt.

Credit risk

The Company invests surplus cash with banks on a short term basis. The treasury policy specifies which counterparties the Company can invest with and sets a limit for the maximum exposure to each counterparty. These limits take account of published credit ratings. There is no material customer credit risk as no individual customer accounts for a significant proportion of income or debt. Note 1(o) of the Financial Statements sets out the Company's bad debt policy.

Foreign currency risk

The Company's policy is that any foreign currency exposure in excess of £100,000 sterling equivalent of a transactional nature, or £3m sterling equivalent of a translation nature, should be covered as soon as they are identified. At 31 March 2017, the Company had forward foreign exchange contracts of £6.8m (31 March 2016: £5.8m) for the purpose of hedging the foreign currency risk of committed future purchases.

Market price risk

The Company's exposure to market price risk principally comprises interest rate exposure. The Company's policy is to accept a degree of interest rate risk. On the basis of the Company's analysis, it is estimated that a 1% rise in interest rates would not have a significant effect.

RISK REPORT

RISK MANAGEMENT FRAMEWORK

The Board sets the tone for risk management within the Company, supported by the Risk & Compliance Committee, and determines the appropriate risk appetite. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment and it aims to ensure an appropriate balance between risk aversion and opportunities. The Board's approach to monitoring, managing and mitigating risk, and the work undertaken by the Risk & Compliance Committee during the year, is set out in the Governance Report.

The ELT implements policies on risk management and internal control, ensuring that risks are appropriately controlled, managed and reported and that remedial action is taken as appropriate. The Company's approach to risk management is set out in our Risk Management Framework, which has been endorsed by the Risk & Compliance Committee, and is managed through a corporate risk model.

The Risk Management Framework sets out our process for identifying, analysing and evaluating risk across the business. Risk champions within each area of the business co-ordinate the identification and assessment of risks for their area of responsibility and record these in a departmental risk register. Risk champions meet on a quarterly basis to share learning and ensure consistency of approach.

Each risk is assessed against defined likelihood and consequence criteria on both an unmanaged and managed basis, producing a risk score. The management controls and responsibilities are documented and the effectiveness of the control assessed. An assurance map details the external and internal assurance provided over the controls. We also set a target risk and, where this is below the current managed risk score, set out an action plan to achieve the desired risk reduction.

Those risks in the departmental risk registers with a managed risk score above a defined threshold are classed as 'significant risks' and are reported in the Corporate Risk Register. This is reviewed monthly by the ELT and at each meeting of the Risk & Compliance Committee.

We define strategic risks as those which are foreseeable, but not with sufficient clarity to be assessed within the corporate risk model. These are captured in a Strategic Risk Register and a sub-group of the Board reviews these strategic risks annually. In 2016, our internal audit co-source partner, KPMG, assisted in this review.

PRINCIPAL RISKS AND UNCERTAINTIES

The Risk & Compliance Committee, on behalf of the Board, carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, taking account of both the highest rated risks on our Corporate Risk Register and the Strategic Risk Register identified by the Board sub-group.

The principal business risks facing the Company, and our approach to mitigating these risks, are set out in the table below. The table also shows how these risks relate to our business outcomes and any changes in the level of risk compared to last year. These principal risks have also been considered in our assessment of financial resilience, as set out in our viability statement on page 75.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Health & safety The nature of our operational and construction workplaces means that there is a significant inherent risk to the health and safety of our staff and supply chain of which we are acutely conscious. *Our workplaces are healthy and safe*	The health and safety of our staff, contractors and members of the public is our highest priority. We are proud of our record of maintaining a healthy and safe workplace, but not complacent, and we are working hard to improve this further. Health and safety matters are given a high priority at all meetings of our ELT and Board. Long term planning and targets set to drive continuous improvement. This is underpinned by our focus on improving behavioural safety and creating a great safety culture. Our health and safety management system defines clear arrangements and responsibilities for implementation and management throughout the Company, and this is externally audited as part of our OHSAS 18001 certification.	No change (continuous improvement).
Customer trust and confidence Our customers are at the heart of everything we do and failure to deliver a consistently unrivalled customer experience or negative media coverage resulting in a poor public perception of our reputation could damage our customers' trust and confidence in our business. *We provide excellent service and impress our customers* *Our customers consider the services they receive to be value for money* *We are a company that customers can trust*	Our unrivalled customer experience strategy was co-created with our customers so that we could understand what was really important to them. We continue to involve customers through active participation in a number of critical pieces of work that are shaping future service and experience. We also continue to improve our support for customers in vulnerable circumstances and engage with them regularly to understand their needs. Our people are supported to deliver an unrivalled customer experience through ongoing investment in their skills including through our cultural change programme, Our Way. We are investing in significant improvements in our customer facing systems through our ONCE programme and we are now looking at how to make sure digital experience is also unrivalled.	New principal risk.
Water service failure A problem in our water system could cause either a major loss of supply or for unfit water to be supplied. This could have many potential causes, including the failure of a strategic water main or treatment works, loss of power supply or contamination of a service reservoir. *We provide a reliable and sufficient supply of water* *We supply clean, clear drinking water that tastes good*	We operate risk-based prioritisation process for the maintenance and replacement of our assets. We are ISO 55001 (Asset Management) certified on a company-wide basis, demonstrating that we follow best practice in the long term management of our assets. We monitor the effectiveness of our asset management through a number of asset health measures. We have well developed business continuity plans in place for managing incidents, down to a site specific level. These are regularly tested. We restrict access to our treated water network through authorisation and physical security measures.	No change.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Sewerage service failure A problem in our sewerage system could cause either significant environmental pollution or flooding of customer properties. This could have many potential causes, including insufficient network capacity to cope with severe weather events, misconnected properties and the consequences of sewer blockages or collapses. *We provide a sewerage service that deals effectively with sewage and heavy rainfall*	We continue to invest heavily in preventing pollution and sewer flooding, which share many of the same root causes. We have developed a pollution management programme with multiple workstreams, to tackle these root causes. A key part of this involves engaging with our customers and local communities through initiatives such as 'Love Your Drain' and Water Rangers, inspections to identify misconnections, and working with partners to deliver SUDS. We are also investing significantly in proactive maintenance and cleaning of the network, real time monitoring and analysis to enable early intervention, flooding mitigation and, where appropriate, investment to increase network capacity.	Increased scale of fines for serious pollution incidents.
Information management failure This risk could take several forms. Key business systems could be lost as a result of a malicious attack or failure of cyber security. Sensitive data could be released in breach of the Data Protection Act or Environmental Information Regulations (EIR). The integrity of our billing data could be lost during transition to a new billing system for household customers. *We are a company that customers can trust*	Our Information Security policy sets out our commitment to the continuous improvement of information security controls and culture throughout the business. This is delivered through software and hardware access controls, additional levels of security for web-facing systems and clear policies and procedures and user awareness, supported by briefings and training. We have implemented a resilient infrastructure which includes full back-up and recovery, and also fail-over to other hardware in the event of a local failure. Data is protected through access controls, laptop encryption and awareness briefings. A ten point data protection action plan has been developed to further mitigate the risks. This activity is supported by a dedicated team covering security, data protection and EIR. Our programme to deliver a new household billing system is supported by robust governance arrangements. This includes a programme board led by two ELT members, reporting regularly into the Risk & Compliance Committee, supported by an experienced system integrator and external assurance from Deloitte LLP.	No change.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Regulatory and political changes Changes to the Licence or regulatory methodology could impact adversely on the balance of risk and return or reduce investor confidence in the stability and predictability of the regulatory framework. A change in government could introduce significant changes in policy, impacting upon the Company. *Our finances are sound, stable and achieve a fair balance between customers and investors*	Externally driven, but we actively engage with Ofwat through responding to formal consultations, regular direct dialogue, contributing to the 'market for ideas' and through other forums such as Water UK.	Significant changes expected in PR19 methodology. Increased political volatility.
Increased competition Ofwat's plans to introduce upstream competition in April 2020, in the areas of water resources and bioresources, will introduce volume risk and risk of asset stranding for future investment in these areas. Potential introduction of household retail competition, unsupported by a clear benefits case, could increase costs and place revenue at risk. *Our finances are sound, stable and achieve a fair balance between customers and investors*	We are engaging with Ofwat on how the new markets will operate and reviewing potential impacts on our business. We contributed to Ofwat's call for evidence in respect of their assessment of the costs and benefits of household retail competition. Ofwat presented their findings to government and we await further information as to how this is to be taken forward.	Upstream competition will introduce limited increased risk. No change on potential for household competition.
Funding and liquidity risk A key funding risk would be an inability to access future funding at acceptable rates due to market uncertainty or in the event of a credit rating downgrade. Also, the loss of EIB as a source of low cost funding, due to Brexit, would increase borrowing costs. Liquidity risk could arise due to breaching financial covenants on standby borrowing facilities. *Our finances are sound, stable and achieve a fair balance between customers and investors*	The Board has approved treasury policies which set out how we manage treasury risks (see page 42). Our five year plans identify future borrowing requirements and we plan our financing strategy accordingly over this time horizon. This is supported by £350m of standby committed borrowing facilities, which were undrawn at 31 March 2017, and we maintain substantial headroom in the financial covenants for these facilities. We are committed to maintaining our strong investment grade credit ratings and manage our financial plans accordingly. Our viability statement on page 75 reports on the financial resilience of our plan over a five year time horizon.	Risk remains heightened due to uncertainty in financial markets as a result of the UK's process to exit the EU.

DESCRIPTION OF RISK	MITIGATION	CHANGE FROM PRIOR YEAR
Financial performance A failure to deliver our financial plans could impact on expected shareholder returns. This could result from significant adverse movements on costs, interest or tax or a failure to deliver efficiency commitments. A sustained period of low RPI could depress RCV, increasing gearing. An increase in defined benefit pension liabilities could require additional contributions to be paid into the pension scheme. *Our finances are sound, stable and achieve a fair balance between customers and investors*	We are implementing a range of efficiency actions for both operating and capital expenditure under our Working Smarter programme and progress is reported monthly to ELT. We have fixed commodity prices for electricity and fuel to March 2020 and maintain more than 50% of our borrowings on fixed rates, providing certainty. We are currently undertaking an actuarial valuation of our defined benefit pension scheme and will agree a contribution schedule with the Trustee. Our employer covenant remains strong, reflecting the long term nature of our business and 25 year rolling term of our Operating Licence. Our viability statement on page 75 reports on the financial resilience of our plan over a five year time horizon.	Reduced risk to gearing due to the high level of prevailing RPI. Increased risk to pension contributions due to market conditions at actuarial valuation date.

NEW RISKS

As part of their assessment of principal risks and taking account of the importance that the Company places on delivering an unrivalled customer experience, the Risk & Compliance Committee decided that the risk of losing customer trust and confidence should be added to the principal risks.

The divergence of political policies in respect of the water industry and other matters such as taxation, and the general volatility of the political environment, has resulted in the risk of regulatory changes being extended to cover political changes.

INCREASING RISKS

The uncertainty in the financial markets during the UK's negotiations to leave the EU means that funding risk remains at a heightened level. This has also increased the valuation of defined benefit pension liabilities.

The amount of change anticipated in Ofwat's PR19 methodology, including upstream competition, and uncertainty over the rate of return to be allowed, has increased regulatory risk.

REDUCING RISKS

The risk related to the opening of the NHH retail market has been removed as we were able to demonstrate our readiness for market opening and manage the transition successfully.

By order of the Board

H Mottram, CEO
14 July 2017

STRATEGIC REPORT
GOVERNANCE REPORT
FINANCIAL STATEMENTS

GOVERNANCE REPORT

CHAIRMAN'S INTRODUCTION

This report explains our robust corporate governance, which the Board believes is essential to protect the interests of all our stakeholders.

A J Hunter

The starting point is the UK Corporate Governance Code (UK CGC), to which the Board has close regard, as required by the Company's Instrument of Appointment (the Licence).

The main focus of the UK CGC is the relationship between a company and its shareholders. Listed companies generally have a high number of shareholders, some of whom may not be fully familiar with the risks facing those companies and management's approach to those risks. The UK CGC provides very valuable protection to shareholders in such companies. NWL, by contrast, is a private company with a single ultimate controlling shareholder. As such it is in a very different position from the companies for which the UK CGC was designed. NWL seeks to comply with both the principles and spirit of the UK CGC in this context.

The Company also has in place a further governance code (the NWL Code), developed in discussion with Ofwat in response to their Board leadership, transparency and governance principles (the Ofwat Principles). The NWL Code states NWL's intention that the Board will comprise four Independent Non-Executive Directors (INEDs) (rather than the three required by the Licence), four shareholder-appointed Non-Executive Directors (excluding me as Chairman) and three Executive Directors. As a private company with a single ultimate controlling shareholder, we believe it to be consistent with good corporate governance for there to be significant shareholder representation on the Board. However, the shareholder-appointed Non-Executive Directors (excluding me as Chairman) are not a majority on the Board and are no greater than the number of INEDS, which ensures that the INEDs have a very strong voice. Moreover, our four INEDS are experienced, capable and independent-minded people who bring a diverse range of talents to the Board, as well as a determination to champion customers' interests and maintain first class governance.

I would like to emphasise that the Board functions as an integrated whole and each director understands his or her individual responsibility to act in the best interests of the Company, as well as the importance of the service provided to our customers and our environmental responsibilities. All directors play a full part in Board meetings and shape the Company's strategy, as well as ensuring that customers' interests are central to investment and operational decisions. The composition of the Board ensures a sound balance of experience, knowledge and independence and that decision making is not dominated by any single group.

Paul Rew, our Senior INED, confirms in his report (on page 50) that the INEDs are fully involved in all the main aspects of NWL's governance and, throughout the year, participated in the Board meetings of our holding company, NWGL.

In practice, the Company complies with the Ofwat Principles and with the UK CGC's principles (and more detailed provisions) with very few exceptions. The Corporate Governance report (on page 51) describes and explains those minor aspects of the Ofwat Principles and the UK CGC which we have chosen not to fully adopt.

The Board, supported by the Risk & Compliance Committee, has ultimate responsibility for risk management and determines risk appetite. The Risk & Compliance Committee receives regular updates on the top-rated risks and priorities for assurance and conducts 'deep-dives' into key areas of risk. On the Board's behalf the Risk & Compliance Committee has conducted a robust assessment of the principal risks facing the Company. These risks, and how they are managed, are described on page 43 of the Strategic Report.

Andrew J Hunter
Chairman

SENIOR INDEPENDENT NON-EXECUTIVE DIRECTOR'S REPORT

As Senior Independent Non-executive Director I am pleased to be able to describe the role of NWL's INEDs, and how our Committees support NWL's high standards of corporate governance.


Paul Rew

As confirmed by the Chairman, whose remarks I fully endorse, the INEDs continue to play a key role in NWL's governance, assurance and decision making. I chair the Audit Committee, the Assurance Sub-Group (which I explain below) and the Risk & Compliance Committee; fellow INEDs sit on both of those Committees, the Assurance Sub-Group and the Remuneration Committee. We are therefore fully involved in all the main aspects of NWL's governance and the Board is satisfied that this enables it to ensure that sound governance is maintained. The UK CGC suggests that all Audit Committee members should be INEDs. The Audit Committee comprises three INEDs and two shareholder-appointed NEDs. The Board believes that this balance is appropriate, given that NWL is a private company with a single ultimate controlling shareholder. The INEDs on the Audit Committee have a wide range of skills and experience and the shareholder-appointed NEDs bring great expertise and a clear appreciation of best practice. The Committee works as a unified team to ensure that good governance is maintained. The three members of the Assurance Sub-Group are all INEDs.

The INEDs recognise the increasing need for careful and thorough assurance of many of the key projects being undertaken by NWL, to ensure compliance, efficiency and excellent outcomes for customers. As I reported last year, in order to sharpen the focus on assurance, the Audit Committee invited the Assurance Sub-Group to closely review (i) NWL's preparations for the opening of the NHH retail market; and (ii) NWL's major transformation project to procure a new billing system and facilitate working with MOSL upon the market opening. This year, the Assurance Sub-Group has held three meetings with management and independent assurance providers, which has enabled the Board to achieve a high degree of confidence that these projects are being delivered to a high standard. I am happy to confirm, as mentioned elsewhere in this document, that the transition to the new, competitive NHH retail market has been smooth.

Most decisions relating to NWL are made by the NWL Board alone and the only decisions referred to the NWGL Board are certain large contract awards, capital project approvals, substantial funding arrangements and the re-appointment of certain Directors. During the last year, the NWGL Board has endorsed all the recommendations of the NWL Board. Although the INEDs are not members of the NWGL Board, we have been present at its Board meetings this year and participated fully, which has encouraged a cohesive approach at both Boards.

I would like to emphasise that, in addition to our work on assurance and our participation in formal meetings, the INEDs have had very broad involvement in NWL's overall business. We have all taken part in extensive sessions with management on risk and customer service. We have also met from time to time without management or the other directors being present and attended seminars arranged by Ofwat and other events relating to the water sector.

I remain satisfied that the balance of experience and expertise on the Board of NWL, its Committees and the Assurance Sub-Group ensures that good compliance and governance are achieved and that the interests of all the Company's stakeholders, and especially customers, are protected.

P Rew
Senior Independent Non-Executive Director

CORPORATE GOVERNANCE

BOARD MEMBERSHIP

The composition of the NWL Board is as follows:

A J Hunter (Non-Executive Chairman) joined the Board in October 2011. He was appointed by CK Infrastructure Holdings Limited (CKI), which is listed on the Hong Kong Stock Exchange and is a substantial shareholder in the Group. A J Hunter is Deputy Managing Director of CKI and is an Executive Director of Power Assets Holdings Limited, a listed company. He has been an Executive Director of CKI since December 2006 and Deputy Managing Director since May 2010. He acted as the Chief Operating Officer of CKI from December 2006 to May 2010. Prior to his appointment to the board of Power Assets Holdings Limited in 1999, Mr Hunter was Finance Director of the Hutchison Property Group. He holds a Master of Arts degree and a Master's degree in Business Administration. He is a member of the Institute of Chartered Accountants of Scotland and of the Hong Kong Institute of Certified Public Accountants. He chairs the Remuneration Committee.

Key strengths: Leadership, strategic overview, finance and infrastructure.

P Rew (Senior Independent Non-Executive Director) joined the Board in 2010. He is a Chartered Accountant and was a partner in PricewaterhouseCoopers LLP (PwC) from 1987 until 2010, where he was lead partner for a diverse range of FTSE 100 clients and for PwC's UK energy, utilities and mining sector practice. He is a Non-Executive Director of DEFRA and the Care Quality Commission and chairs their Audit Committees, and was formerly a Non-Executive Director of the Met Office. He chairs the Audit Committee and Risk & Compliance Committee and is also a member of the Remuneration Committee.

Key strengths: Finance, risk and governance.

H Mottram (CEO) joined the Board in 2010, when she was appointed as CEO of NWL and NWGL. Prior to her current position, Ms Mottram held a number of senior management roles, including Managing Director of Northern Rail Limited, Commercial Director of Arriva Trains and Operations Director of Midland Mainline, as well as various senior positions in Great North Eastern Railway. She is a Non-Executive Director of Eurostar International Limited and a Board Member of the North East Local Enterprise Partnership. She is also a Board Member of Kielder Water and Forest Park Development Trust, as well as a member of the CBI Board and Newcastle University Council. Ms Mottram was named Rail Business Manager of the Year in 2009 for being an ''inspirational leader'', she was awarded an OBE in the New Year honours list in 2010 for services to the rail industry and is also the Prince of Wales' Ambassador for Business in the north east of England

Key strengths: Leadership, corporate overview, infrastructure and customer service.

C I Johns (Finance Director) joined the Board in 2013. He was previously Finance Director of Northern Gas Networks Limited (NGN) since 2005, which is also part of the Cheung Kong Group. Before joining NGN, C I Johns worked in the financial services sector. He is a Chartered Accountant and has held senior financial management positions in both Yorkshire and London. His previous positions include being Head of Finance and Accounting within the UK lending operations of Provident Financial plc, and a senior management role in the Financial Reporting and Control Group of Morgan Stanley.

Key strengths: Finance and infrastructure.

A C Jones (Assets and Assurance Director) joined

A C Jones

the NWL Board in 2004. An economist by background, he holds an MBA with distinction from Warwick and has extensive experience in dealing with government and regulatory bodies. He is a Chartered Environmentalist and worked as a government economist and economic consultant before joining the water industry and has held non-executive positions at a number of water industry organisations and is currently Vice Chair of a locally based enterprise development business.

Key strengths: Economic regulation and corporate planning.

M Fay

M Fay (Independent Non-Executive Director) joined the Board in 2010. She was Managing Director of Tyne Tees Television until December 2003 when she became Chairman of One North East, a position she held until August 2010. She is Deputy Chairman of The Sage Gateshead, a Governor of the University of Sunderland, Patron of Tees Valley Community Foundation and a Deputy Lieutenant for Tyne and Wear. M Fay is a member of the Remuneration Committee.

Key strengths: Corporate overview and customer service.

Dr S Lyster

Dr S Lyster (Independent Non-Executive Director) joined the Board in 2006. He is a lawyer by training, qualified in both the UK and the USA and is the author of the leading legal textbook on wildlife law. Dr Lyster was Chief Executive of LEAD International from 2005 to 2011. Before joining LEAD, he was Director General of The Wildlife Trusts and previously worked for World Wildlife Fund for nine years, where he was responsible for its global policy work on international conventions. He is Chairman of the World Land Trust and a Trustee of Conservation International-UK, the Kilverstone Wildlife Conservation Trust and the Rural Community Council of Essex. In July 2014, Dr Lyster was appointed to the Board of Natural England and he is a Deputy Lieutenant for the County of Essex. Dr Lyster is a member of the Audit Committee, Risk & Compliance and Remuneration Committees.

Key strengths: Conservation, the environment and law.

M A B Nègre

M A B Nègre (Independent Non-Executive Director) joined the Board in 2006. He was, between April 2000 and April 2001, the CEO of the former Northumbrian Water Group plc and the chief corporate representative of its parent company, Suez, in the UK. He was a founding Director of NWGL when it acquired the Group from Suez SA in 2003. He currently chairs Ecofin Vista Hedge Fund Limited, is a Non-Executive Director of listed Investment Trust EGL plc and holds a number of Directorships focused on utilities. He sits on the supervisory board of Messieurs Hottinger & Cie. M A B Nègre is a member of the Audit Committee and Risk & Compliance Committee.

Key strengths: Strategy and infrastructure.

F R Frame

F R Frame (Non-Executive Director) joined the Board in November 2011 and was appointed by Li Ka Shing Foundation Limited, a company limited by guarantee and a charity, which is a substantial shareholder in the Company. A lawyer by profession, Mr Frame served as Deputy Chairman of the Hongkong and Shanghai Banking Corporation; as Chairman of South China Morning Post Limited and The Wallem Group Limited; and as a Director of The Weir Group plc, Swire Pacific Limited, the British Bank of the Middle East, Edinburgh Dragon Trust plc, Baxter International Inc and Consolidated Press International Limited. He holds the degrees of Master of Arts and Bachelor of Laws.

Key strengths: Corporate overview and law.

H L Kam

H L Kam (Non-Executive Director) joined the Board in October 2011. He was appointed by Cheung Kong (Holdings) Limited (CKH), which is a substantial shareholder in the Company and is now wholly-owned by CK Hutchison Holdings Limited (CKHH). He is Group Managing Director of CKI and Deputy Managing Director of CKHH. H L Kam has been Group Managing Director of CKI since its incorporation in May 1996. He has also been Deputy Managing Director of CKH since February 1993. He is President and Chief Executive Officer of CK Life Sciences Int'l., (Holdings) Inc., and an Executive Director of Hutchison Whampoa Limited and Power Assets Holdings Limited. Mr Kam is also Chairman of Hui Xian Asset Management Limited, which manages Hui Xian Real Estate Investment Trust, a listed real estate investment trust. He holds a Bachelor of Science degree in Engineering and a Master's degree in Business Administration.

Key strengths: Leadership, strategic overview, finance and infrastructure.

D N Macrae (Non-Executive Director) joined the Board in October 2011. He was appointed by CKI, where he holds the position of Head of International Business. D N Macrae has over 22 years of experience in the infrastructure investment field and holds a Bachelor's and a Master's degree in Philosophy, Politics & Economics. He is a member of the Audit Committee and Remuneration Committee.

Key strengths: Finance, infrastructure and corporate overview.

L S Chan (Non-Executive Director) joined the Board in 2016. He was appointed by CKH and has been an Executive Director of CKI since January 2011 and Chief Financial Officer of CKI since January 2006. He joined Hutchison Whampoa Limited, which is a substantial shareholder of CKI, in January 1992 and has been with the Cheung Kong Group since May 1994. Mr Chan is a fellow of the Hong Kong Institute of Certified Public Accountants, a fellow of the Association of Chartered Certified Accountants and also a member of the Institute of Certified Management Accountants (Australia). He is a member of the Audit Committee and Risk & Compliance Committee.

Key strengths: Finance, infrastructure and corporate overview.

The Chairman and CEO have clearly defined roles and responsibilities. The Chairman leads the Board and creates the conditions for overall Board and individual Director effectiveness, both inside and outside the boardroom. The CEO is responsible for running the Company's business on a day-to-day basis. A J Hunter, D N Macrae, H L Kam, F R Frame and H Mottram were also Directors of NWGL in the year.

The Non-Executive Directors bring to the Board many years of business experience as well as financial expertise and the ability and willingness to constructively challenge and help develop proposals on strategy.

The General Counsel and Company Secretary, M Parker, assists the Board to ensure that good corporate governance compliance is achieved. He is also Company Secretary of NWGL and is secretary to all Board committees.

ATTENDANCE AT BOARD MEETINGS

Attendance at the five scheduled meetings during the year was as follows:

NAME	ATTENDANCE
A J Hunter	5
P Rew	5
H Mottram	5
C I Johns	5
A C Jones	5
M Fay CBE	5
Dr S Lyster	5
M A B Nègre	5
F R Frame	4
H L Kam	4
D N Macrae	5
L S Chan	5

CORPORATE GOVERNANCE OBLIGATIONS

The Boards of the Company and its holding company, NWGL, are committed to high standards of corporate governance. The Company's Licence contains provisions to ensure that the Company's governance is sound and that its Directors, acting as such, act independently of parent companies. The Licence requires the Company to have particular regard to the UK CGC. Good governance is further underpinned by the Ofwat Principles and the bespoke Governance Code (the NWL Code), which the Board put in place in March 2014, following discussion with Ofwat in response to the Ofwat Principles.

The arrangements and functioning of the Board and its Committees adhere to the Licence obligations and follow the NWL Code, the Ofwat Principles and the UK CGC, subject to the exceptions explained below. The Board believes that, as a private company with a single ultimate shareholder, it is consistent with good corporate governance for there to be significant shareholder representation on the Board. The Board considers that the balance which has been achieved ensures good governance and takes account of the interests of shareholders, customers and other stakeholders. There are four INEDs, four shareholder-appointed Non-Executive Directors (excluding the Chairman) and three Executive Directors. The composition of the Board does not comply with the UK CGC's guidance that at least half the Board, excluding the Chairman, should be INEDs or with the Ofwat Principle that INEDs should be the largest single group on the Board. However, the Board is satisfied with the mitigation put in place to ensure that good governance is achieved. This includes the appointment of four INEDs, rather than the three required by the Licence. Although not technically independent, a fifth Non-executive director, F Frame, is not and never has been an employee of the shareholders and brings an additional strong and experienced voice to the Board. F Frame, a lawyer by profession, was appointed by the Li Ka Shing Foundation Limited, itself a charitable foundation.

The Chairman comments (in his introduction to the Governance Report on page 49) on the balance of the Board, which functions as an integrated whole, and the quality and contribution of the INEDs. The Chairman ensures that the Board works in a collegiate way, in the best interests of the Company, and that each director has an equal voice. All members of the Board are content that the balance of the Board is appropriate, in the context of a private company with a single ultimate controlling shareholder, and that it has supported and delivered good governance.

The Licence requires the Company to obtain undertakings from its ultimate controllers to underpin the Licence and to require the Company's Board to include 'not less than three independent Non-Executive Directors, who shall be persons of standing with relevant experience' and who have collective knowledge of, and connections with, the Company's areas of supply and customers. Throughout the year, the Company had four INEDs, P Rew, Dr S Lyster and M Fay (who were the three INEDs for the purposes of the Licence) and M A B Nègre. Their biographical details are set out on pages 51 to 53. They were appointed on the recommendation of the Nomination Committee of Northumbrian Water Group plc, when it was independently listed.

The INEDs have attended and participated in decisions at all NWGL Board meetings, at meetings of the Audit, Risk & Compliance and Remuneration Committees and at meetings of the Assurance Sub-Group of the Audit Committee (whose members are P Rew (Chairman), Dr S Lyster and M A B Nègre). Whilst these were, throughout the year, formally constituted at the NWGL level, the vast majority of their work related to the Company's activities. The INEDs have therefore played a full part in all strategic decisions both at the NWL and NWGL Boards. All Directors' views have been given full consideration and due weight in all proceedings of the Board and Committees and of the Sub-Group. As explained in the reports of the Audit Committee and Risk & Compliance Committee, below, the Committees are being restructured so that NWL will have its own Audit, Risk & Compliance and Remuneration Committees.

The Board considers that it complies substantially with the relevant provisions of the UK CGC, except as explained on pages 61 to 62. Compliance with the NWL Code is reported on page 62.

HOW THE BOARD OPERATES

The Board sets, implements and supports the Company's vision, values and strategy and ensures compliance with Group policies and legal and regulatory obligations. Within the Group framework, NWL operates as a standalone company and its strategy is determined solely by the NWL Board. During the year, the only decisions referred to the NWGL Board were certain large contract awards, capital project approvals and substantial funding arrangements and, in each case, the NWGL Board accepted the recommendations of the NWL Board.

The Board has ultimate responsibility for risk management and determines the appropriate risk appetite. The Board's view of acceptable risk is based on a balanced view of all of the risks in the operating environment and it aims to ensure an appropriate balance between risk aversion and opportunities. The Board monitors the management of fundamental risks and approves major decisions affecting the Company's risk profile. The Board is supported in this by the Risk & Compliance Committee, from which it receives regular and detailed reports.

The Board requires management to identify and assess the impact of risks to the business using a corporate risk model. In addition, during the year, a sub group of the Board carried out a review of strategic risks, being potentially high impact risks which are foreseeable but with a high degree of uncertainty.

The Board receives detailed reports from the Executive Directors in advance of Board meetings, covering each aspect of the Company's activities. Health and Safety is a key substantive item on each Board agenda and the Company's excellent health and safety record is detailed on page 35. There are also regular reports on operational performance, customer service, management of key business risks, the investment programme and regulatory matters. There is a strong focus on the Company's success in delivering its key outcomes, as explained in the Strategic Report. The Chairman of the Audit Committee and Assurance Sub-Committee reports fully to the Board on their work.

The Chairman ensures that all items on the Board agendas are discussed openly and that all Directors have an opportunity to express their views. He encourages constructive challenge, so that ideas and proposals are tested and explored fully. The Board recognises that customers' interests are best served when the Company is flexible and innovative, so the Executive team is always encouraged to think laterally and consider a range of solutions for each issue.

The Company has adopted terms of reference which set out the matters reserved to the Board for approval and matters which are, or can be, delegated to the Committees and management. The Board makes key strategic decisions and approves the annual and medium term business plans. It also approves regulatory submissions and very significant investments or expenditure which is not in the normal course of business. Investments which form part of projects within approved business plans are authorised by committees below Board level.

The Company has also adopted financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions within the Company. The terms of reference and financial approval rules are reviewed regularly by the Board. The Standing or Executive Committees can take decisions not delegated to specific committees between Board meetings. All Directors receive notice of Standing Committee meetings and may participate if they wish. Decisions taken by the Standing or Executive Committees are reported at the next Board meeting. The Company's Board meets at least five times each year.

AUTHORISATION OF DIRECTORS' CONFLICTS OF INTEREST

Directors have a statutory duty, under s175 of the Companies Act 2006, to avoid a situation in which they have, or could have, a conflict of interest with the Company's interests. However, there is no breach of this duty if the Board has authorised the matter in question. The Articles permit Directors (other than the Director having the interest in question) to authorise any situation giving rise to a known or potential conflict. A register of the interests which have been authorised is maintained by the Company Secretary and is available at every Board meeting.

BOARD COMMITTEES

During the year, the Board had Audit, Risk & Compliance and Remuneration Committees to assist it in the performance of its duties. The Board sets the terms of reference of the Committees and receives regular reports from their chairmen at Board meetings. Reports from the Audit Committee, Risk & Compliance and Remuneration Committees are set out below.

AUDIT COMMITTEE REPORT

Introduction by the Chairman of the Committee, Paul Rew

The role of the Audit Committee is to assist both Executive and Non-Executive Directors of Group companies to discharge their individual and collective responsibilities in relation to:

- ensuring the financial and accounting systems of each Group company are providing accurate and up-to-date information on its current position;
- ensuring the Group's published financial statements represent a true and fair reflection of this position;
- ensuring the integrity of the Company's regulatory reporting systems and the accuracy of its regulatory reports; and
- assessing the integrity of its internal financial controls.

The Committee also maintains oversight of internal and external auditors. I have worked with the members of the Committee and with management to produce an action plan for the Committee, setting out the business to be addressed at each meeting. This plan is dynamic and is updated throughout the year. The members of the Committee are updated regularly on developments in financial reporting requirements and on any changes in NWL's regulatory environment.

Members of the Audit Committee

The members of the Audit Committee are P Rew (Chairman), Dr S Lyster, M A B Nègre, D N Macrae and L S Chan.

The CEO, Finance Director, Assets and Assurance Director, Internal Audit Manager and the external auditor normally attend the Committee's meetings by invitation and Martin Parker is secretary to the Committee. Other senior managers and advisers are invited to attend as appropriate.

The work of the Audit Committee

During the year, and up to the date of approval of these financial statements, the Audit Committee assisted both Executive and Non-Executive Directors to discharge their individual and collective responsibilities. Its work included the following:

- reviewing the draft financial statements and APR, considering reports from the external auditor setting out the audit approach and plan, significant audit risks and conclusions on the Group's internal controls and risk management;
- reviewing the appropriateness of accounting policies, significant accounting judgements and evidence supporting the going concern basis for the Financial Statements and recommending approval of the Financial Statements to the Board;
- reviewing and commenting on the APR, including the underlying assurance, reviewing evidence to support the Condition F6A.2A certificate (statement of sufficiency of financial resources) and recommending its approval to the Board;
- confirming the objectivity and independence of the external auditor, and in so doing reviewing the representations made in the audit report on these subjects;
- approving the external auditor's fees for both audit and non-audit services, by reference to the agreed policy;
- monitoring the effectiveness of the internal audit function;
- approving the internal audit work programme for the year and reviewing progress against the programme;
- approving arrangements for monitoring compliance with the Company's procedures designed to prevent bribery, having regard to the Bribery Act 2010 and the updated code of conduct 'Our Way at NWG', including receiving reports on any whistleblowing allegations; and
- reviewing the risk and control framework and reporting, including management of tax compliance matters and approval of financial approval rules.

Set out below is a brief summary of the breakdown of work across the Committee's meetings:

Meeting on 17 May 2016:

- Reviewing internal auditor's update on progress against the annual internal audit plan;
- Reviewing the Group tax update;
- Reviewing the draft viability and financial resilience statements; and
- Reviewing the draft 2016 corporate governance report.

Meeting on 23 June 2016:

- Reviewing the external audit results for the year ended 31 March 2016;
- Reviewing the accounting policies and significant accounting judgements to be applied, and considering evidence to support the going concern and viability statements, in the NWL Financial Statements;
- Reviewing the Annual Performance Report for 2015/16; and
- Reviewing the draft 2016 corporate governance report.

Meeting on 18 October 2016:

- Reviewing the internal auditor's update on progress against plan for the year ending 31 December 2016 and the plan for the year ending 31 December 2017;
- Conducting the annual review of the effectiveness of the external audit process;
- Reviewing the Group tax update;
- Considering the December 2016 Group reporting audit plan summary; and
- Agreeing the format of the annual review of effectiveness of the Committee.

Meeting on 14 February 2017:

- Receiving the external audit report for the year ending 31 December 2016 and March 2017 audit planning;
- Reviewing the internal auditor's update on progress against plan for the year ending 31 December 2017;
- Reviewing the revised policy for the provision of non-audit services;
- Discussing Group tax strategy;
- Reviewing the draft Statutory Transfer Scheme for the transfer of NWL's NHH retail business to NWG Business Limited;
- Reviewing the overall approach to March 2017 reporting; and
- 'In camera' session with Deloitte, without management being present.

Meeting on 16 May 2017:

- Reviewing the internal auditor's update on progress against plan for the year ending 31 December 2017;
- Reviewing Deloitte's stage gate review of progress with the new customer experience and billing system;
- Reviewing the tax strategy and tax update;
- Reviewing the draft viability statement and stress test outputs;
- Reviewing the draft 2017 Governance Report; and
- Agreeing a proposal to put in place procedures following the introduction of the Criminal Finances Act 2017.

Meeting on 19 June 2017:

- Reviewing the external audit results for the year ended 31 March 2017;
- Reviewing NWL's draft Annual Report and Financial Statements for the year ended 31 March 2017;
- Reviewing NWL's draft Annual Performance Report and Data Assurance Summary for the year ended 31 March 2017; and
- Reviewing an update on additional Ofwat data submissions.

The Audit Committee Chairman reports formally to the NWGL and NWL Boards following each Audit Committee meeting and its minutes are circulated to both Boards.

Attendance at the four Audit Committee meetings during the year was as follows:

NAME	ATTENDANCE
P Rew	4
Dr S Lyster	4
M A B Nègre	4
D N Macrae	3
L S Chan	4

Given the increasing need for careful and thorough assurance of a number of NWL's key projects, to ensure compliance, efficiency and excellent customer outcomes, the Audit Committee has an Assurance Sub-Group whose three members are all INEDs. Although the Sub-Group has a broad remit, its work during the year has focused on NWL's preparations for the opening of the NHH retail market and NWL's major transformation project to implement a new billing system to enable NWL to work with MOSL after market opening and, at a later date, manage household customer billing and contact. The

Sub-Group has held three meetings with Executive Directors, senior management and independent assurance providers during the year and attendance was as follows:

NAME	ATTENDANCE
P Rew	3
Dr S Lyster	3
M A B Nègre	3

Following the opening of the NHH retail market in April 2017, the Board is establishing a separate NWL Audit Committee, to be supported by an NWL Assurance Sub-Committee.

P Rew
Chairman of the Audit Committee

RISK & COMPLIANCE COMMITTEE REPORT

Introduction by the Chairman of the Committee, Paul Rew

The role of the Committee is to assist both Executive and Non-Executive Directors to discharge their individual and collective responsibilities in relation to assessing the scope and effectiveness of the Group's risk management systems and the integrity of its internal financial controls.

Members of the Risk & Compliance Committee

The members of the Risk & Compliance Committee are P Rew (Chairman), Dr S Lyster and M Nègre.

The work of the Risk & Compliance Committee

The Executive Leadership Team implements policies on risk management and internal control and ensures that risks are appropriately identified and managed within the business. This approach is set out in a Risk Management Framework, which has been endorsed by the Risk & Compliance Committee. The ELT reviews the approach to risk management in detail every year and reviews the significant risks every month. Any significant issues are reported by the CEO to the Board. Senior management implements policies on risk management and internal control.

The Risk & Compliance Committee, on behalf of the Board, has performed a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. These principal risks, and how they are managed, are described on pages 43 to 47 in the Strategic Report.

The internal control framework supports the risk management process, ensuring that risks are appropriately managed, that controls are effective and that appropriate remedial action is taken where identified. Risks are mapped against the providers of assurance, whether this be management, internal or external assurance. The Board is supported by the Audit Committee in monitoring the effectiveness of the internal control framework with primary assurance being provided by the Internal Audit team.

The Risk & Compliance Committee, on behalf of the Board, has carried out an annual review of the effectiveness of the Company's risk management and internal control systems. This review confirmed that the Company has strong systems of internal control and robust processes in place to enable it to identify, evaluate and manage the risks it faces and to ensure that its obligations are met. These systems and processes are embedded in the organisation and are reviewed regularly by the Board and its Committees. The annual review confirmed that the risk management and internal control systems have operated effectively through the year and that there have been no significant failings or weaknesses.

During the year, and up to the date of approval of these financial statements, the work of the Risk & Compliance Committee included the following:

- completing the implementation of a significantly enhanced risk management framework and corporate risk register, based on a detailed bottom-up assessment of risk across the Company and departmental risk registers developed by risk champions in each department;
- reviewing reports at each meeting on the top rated managed risks and priorities for assurance (being those risks with the biggest reduction between the business (gross) and managed (net) risk scores), representing key control areas for the Company;
- reviewing the management of specific areas of risk in relation to health and safety, the vehicle operator's licence and environmental compliance;
- reviewing cyber security and steps being taken to enhance security;
- advising the Board on risk appetite and exposure and reviewing risk assessment processes as well as keeping the effectiveness of the risk and internal control management systems under review;
- monitoring compliance with covenants and treasury risks;
- reviewing management of customer debt; and
- reviewing business continuity arrangements.

The effectiveness of the Risk & Compliance Committee is enhanced by 'deep-dive' sessions at which specific risks are addressed in great detail.

Set out below is a brief summary of the breakdown of work across the Committee's meetings:

Meeting on 23 June 2016:

- Reviewing the customer debt report, including collection performance, provisioning and future risks;
- Reviewing the top-rated risks and priorities for assurance;
- Reviewing the treasury report and update on covenant compliance;
- Reviewing the effectiveness of risk management and internal controls;
- Reviewing the principal risks; and
- Reviewing the forward business plan for 2016/17.

Meeting on 17 October 2016:

- Reviewing the customer debt report, including collection performance, provisioning and future risks;
- Reviewing the update on top-rated risks and priorities for assurance;
- Conducting a "Deep dive" into the work underway to reduce pollution incidents;
- Reviewing the business continuity; and
- Review the treasury report and update on covenant compliance.

Meeting on 18 November 2016:

- Fully reviewing strategic risks.

Meeting on 14 February 2017:

- Reviewing the customer debt report, including collection performance, provisioning and future risks;
- Reviewing the top-rated risks and priorities for assurance; and
- Reviewing the treasury report and update on covenant compliance.

Meeting on 16 May 2017:

- Reviewing the debt report;
- Reviewing the top-rated risks and priorities for assurance;
- Reviewing the treasury report and covenant update;
- Reviewing the effectiveness of control systems and conducting an assessment of principal risks; and
- Reviewing the committee structure.

Attendance at the four scheduled Risk & Compliance Committee meetings during the year was as follows:

NAME	ATTENDANCE
P Rew	4
Dr S Lyster	4
M A B Nègre	4

The Board is able to monitor the impact of environmental, social and governance matters on the Company's business, to assess the impact of significant risks on the business and to evaluate methods of managing these risks through reports it receives from the Audit Committee and the Risk & Compliance Committee.

Following the opening of the NHH retail market in April 2017, the Board is establishing a separate NWL Risk & Compliance Sub-Committee of the NWL Audit Committee.

P Rew
Chairman of the Risk & Compliance Committee

THE UK CORPORATE GOVERNANCE CODE

The Board considers that it complies substantially with the relevant provisions of the UK CGC where they are appropriate for a privately held company, except as explained below.

Code Provisions

A.3.1: The Chairman was appointed by the Group's shareholders which is considered to be appropriate, given that NWL is a private company with a single ultimate controlling shareholder. As per the Ofwat Principles, there is a Senior INED, P Rew, who is available to Ofwat in respect of any regulatory matter.

A.4.2: The Chairman has informal discussions with the Non-Executive Directors (both individually and collectively) as the need arises, though it has not been felt necessary to hold formal meetings with them without the executives present. The Non-Executive Directors have not formally appraised the performance during the year of the Chairman, but all Directors had the opportunity to comment on his performance on a confidential basis as part of the recent Board evaluation.

B.1.2: The Board comprises a Chairman and four further Non-Executive Directors appointed by the Group's shareholders, four INEDs and three Executive Directors (including the CEO). As explained in the Chairman's Statement, Senior INED's Report and Corporate Governance obligations section on page 54, the Board considers that this is an appropriate balance in the context of a private company with a single ultimate controlling shareholder.

B.2.3: The Board has rigorously reviewed the re-appointment of the following Directors and determined that they are independent for the purposes of the UK CGC, notwithstanding that they have served on the Board for more than six years:

- M A B Nègre (appointed in 2006). Mr Nègre has no prior connections with the Group's shareholders. He is a very experienced director, and brings to the Board an excellent understanding of the business coupled with sound commercial judgment. He continues to contribute a constructive and challenging perspective to Board discussions;
- Dr S Lyster (appointed in 2006). Dr Lyster has no prior connections with the Group or its shareholders. He is a very experienced director, with particular expertise in wildlife, conservation and environmental matters, which are central to the Company's work. He lives in the Company's ESW supply area. The Board is satisfied that Dr Lyster continues to demonstrate a fully independent approach and to offer valuable constructive challenge;
- M Fay (appointed in 2010). Mrs Fay has no prior connections with the Group or its shareholders and brings to the Board very valuable knowledge of, and a strong connection with, NWL's customers in the north east, a passion for customer service and a rigorous approach to corporate governance; and
- P Rew (appointed in 2010). Mr Rew has no prior connections with the Group or its shareholders. He brings expertise in finance, risk and compliance and has very significant experience as an audit committee chairman in substantial and complex organisations.

B.2.1, B.2.2 and B.2.4: There is not currently a permanent Nomination Committee. The Company has confirmed (in its governance document) that new INEDs and Executive Directors will be appointed on an objective basis and by means of a formal, rigorous and transparent procedure, in which all Non-Executive Directors will participate. Moreover, the Board has agreed to ensure that the recruitment process for INEDs is such that a diverse range of candidates is encouraged to apply. The Board intends to introduce a Nomination Committee during 2017.

B.4: INEDs receive induction on joining the Board and continually update their knowledge of and familiarity with the Company. The Chairman does not formally review with each Director their training and development needs. For Executive Directors this is managed by the CEO; Independent Directors keep up to date with developments in the sector via updates at Board meetings and external seminars.

B.6: The Company has conducted an internal review of the Board's performance and the findings were reviewed at the Board meeting in August 2016. The feedback from the review was extremely positive and no material concerns were raised. The performance of Executive Directors is appraised by the CEO and all Executive Directors participate in NWL's extensive 360° feedback system. An internal review of the performance of the Committees was commenced in March 2017 and the Board will review the findings in August 2017. These were, again, generally very positive, identifying only a few minor suggestions for improvement.

The Board rigorously reviews the contributions of any directors whose appointments are extended beyond a term of six years.

B.7: Annual re-election by shareholders is not considered to be appropriate in the case of a privately owned company.

C.3.1: The Audit Committee comprises three INEDs and two shareholder-appointed NEDs. This is considered to be appropriate in the context of a private company with a single ultimate controlling shareholder and the Committee ensures that high standards of governance and good practice are maintained.

D.1: The Company's policy on remuneration and the detailed remuneration disclosures are set out in the Remuneration Committee Report on page 63.

D.2.1: The Remuneration Committee is chaired by AJ Hunter, the shareholder-appointed Chairman of the Board. Although this is not compliant with the Ofwat Principles, it is considered to be appropriate in the context of a private company with a single ultimate controlling shareholder. In this ownership model the shareholders are not exposed to the risk of the Committee agreeing to unduly generous remuneration packages for executive directors. A third INED, S Lyster, joined the Committee during the year and the CEO, H Mottram, has also now stood down from the Committee, meaning that there is now a majority of INEDs in accordance with the Ofwat Principles. There is now an even stronger independent presence on the Committee, which it is hoped will further underpin stakeholder trust and confidence.

Schedule B: There were five Board meetings during the year, as well as four meetings of the Audit Committee, three meetings of the Risk & Compliance Committee and two meetings of the Remuneration Committee.

NORTHUMBRIAN WATER LIMITED BOARD GOVERNANCE CODE

In March 2014, following discussions with Ofwat, the Board put in place a bespoke Governance Code (the NWL Code), which is available on the NWL website. The Company follows the NWL Code and, accordingly, commenced performance evaluations in 2015. As disclosed above, an internal review of the performance of the Board Committees during the year is in progress.

CODE OF CONDUCT

The Group has a code of conduct, 'Our Way at NWG', covering its relationships with customers, employees, suppliers, local communities, shareholders, other investors and regulators. This document was updated during the year and now provides clearer guidance to employees in relation to personal conduct, conflicts of interest and a number of other matters. As part of the annual staff appraisal system, all employees are required to confirm that they have seen the code of conduct.

REMUNERATION COMMITTEE REPORT

The following report has been produced in accordance with section 35A of the Water Industry Act 1991. It also has regard to the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 in respect of Directors' remuneration reporting for quoted companies, albeit in the context of a company which is not a listed public limited company.

ANNUAL STATEMENT

The work of the Remuneration Committee comprises the adoption of principles and standards in relation to executive remuneration and benefits, as well as agreeing individual remuneration packages. All decisions regarding Directors' remuneration are taken by the Remuneration Committee, other than where stated.

Members of the Remuneration Committee

The members of the Remuneration Committee during the year were A J Hunter (Chairman), H Mottram, P Rew, M Fay, S Lyster and D N Macrae. S Lyster joined the Committee in February 2017 and H Mottram resigned from the Committee after the February 2017 meeting. S Salter, from the Executive Leadership Team, provides advice to the Committee from time to time.

H Mottram did not participate in discussions relating to her own remuneration and her personal Short Term Incentive Plan (STIP) targets are set directly by the Chairman. The resignation of H Mottram from the Committee means that there is now a majority of INEDs in accordance with the Ofwat Principles.

The work of the Remuneration Committee

The Remuneration Committee met twice during the year. No substantial changes were made to the directors' remuneration policy, or individual directors' remuneration, during the year. Set out below is a brief summary of the breakdown of work across the Committee's meetings:

Meeting on 9 August 2016:

- Considering and approving the appointment of N Watson as Group Information Services Director.

Meeting on 14 February 2017:

- Reviewing Executive pay and Non-Executive Directors' fees, taking account of market data, and agreed annual pay awards to take effect from 1 January 2017;
- Considering an assurance report from the Internal Audit Manager on performance against targets reflected in incentive recommendations for the 2016 STIP and Long Term Incentive Plan (LTIP);
- Agreeing STIP payments for the 2016 calendar year;
- Agreeing the level at which the LTIP award in respect of the 2016 calendar year would vest;
- Considering the implications of the transfer of NWL's NHH Retail business to NWGB, another subsidiary of NWGL, on future performance targets, particularly in respect of level playing field obligations;
- Setting performance targets for the STIP for Executive Directors and senior managers for the 2017 calendar year; and
- Setting performance targets for the LTIP scheme for the award in respect of the 2017 calendar year.

Attendance at the two Remuneration Committee meetings during the year was as follows:

NAME	ATTENDANCE
A J Hunter	2
M Fay	2
S Lyster	1*
D N Macrae	2
H Mottram	2
P Rew	2

* *S Lyster was only a member for one meeting*

The financial performance targets for the STIP and LTIP include Group profit measures. In view of the opening of the NHH retail market from April 2017, and the need for the NWL wholesale business to operate demonstrably at arms length from NWGB, the NWGB contribution to Group profit has been removed from the targets. This removes any incentive for NWL Directors to benefit from the performance of NWGB.

Following the opening of the NHH retail market, remuneration matters for NWGB have been removed from the scope of the Remuneration Committee and are considered separately.

A J Hunter
Chairman of the Remuneration Committee

DIRECTORS' REMUNERATION POLICY

The policy of the Remuneration Committee is to pay no more than necessary to attract and retain good quality Directors, and to ensure that policy is aligned with market practice. For Executive Directors the reward policy is designed to achieve a balance between attraction, reward for performance and retention, and salaries are based on relevant market benchmarks, which are reviewed typically every three years. For Non-Executive Directors, fees paid reflect market practice for similar sized companies, and may be enhanced for roles leading Board Committees.

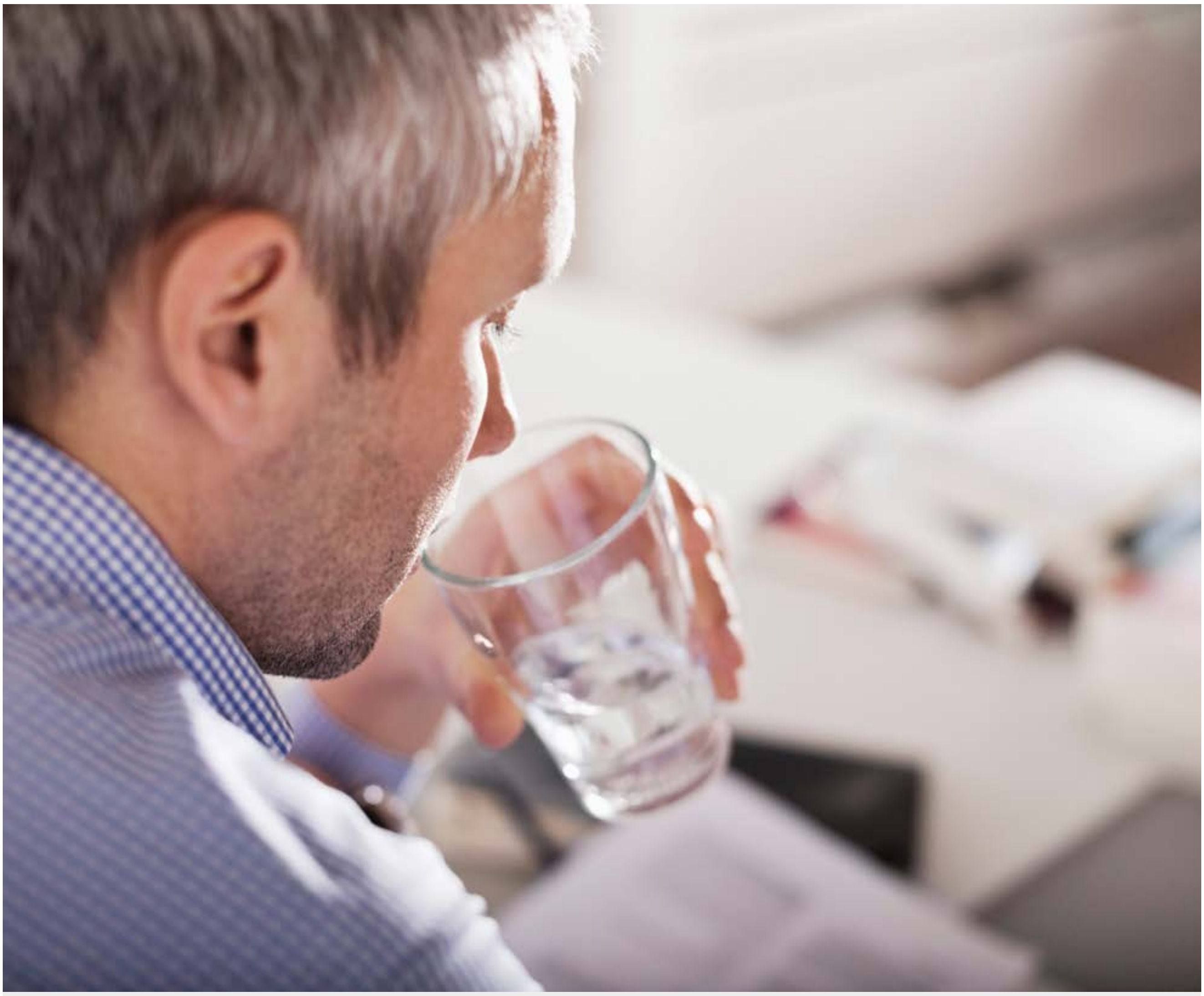
Executive Directors

The remuneration of the Executive Directors comprises:

- basic salary;
- benefits in kind;
- a performance related STIP;
- annual LTIP awards; and
- pension benefits.

In addition to reviewing each constituent element, the Remuneration Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure and quantum. In 2012 the Remuneration Committee restructured the remuneration of the Executive Directors, with advice from Hay Group, independent external reward consultants. This resulted in a reduction in the value of performance related STIP and LTIP awards, offset by an adjustment to basic pay. The Remuneration Committee is satisfied that this balance between fixed and performance related remuneration remains appropriate.

The following table describes the policy in more detail, explaining the purpose of each component, how the policy operates and, for the variable elements of remuneration, the maximum amount payable and how performance is assessed.



PURPOSE	OPERATION	PERFORMANCE ASSESSMENT	MAXIMUM PAYABLE
Basic salary			
Basic salaries are set at a level to attract and retain Directors with the leadership capabilities to deliver the Company's vision of being the national leader in the provision of sustainable water and wastewater services and to reflect the external market.	Basic salary is reviewed annually based on individual contributions, periodic benchmarking to the external market and with regard to the expected pay award for other groups of employees.	The basic salaries payable to Directors of NWL are not directly linked to specific standards of performance in connection with the carrying out of functions of a 'relevant undertaker'. There is no variable performance related element.	Fixed annual amount determined annually by the Remuneration Committee.
Benefits in kind			
Other employment benefits provided in accordance with the Company's policy on provision of benefits to all staff.	Benefits provided to the Executive Directors comprise car and fuel allowances, healthcare and professional subscriptions.	There is no variable performance related element.	Fixed annual amount set in accordance with the Company's policies on provision of benefits to all staff.
STIP			
The purpose of the STIP is to focus on delivering key business performance targets in the year. The performance targets are firmly linked to NWL's strategic themes (customer, competitiveness, people, environment and communities). Stretching targets are set which are aligned to the Company's vision of being the national leader in the provision of sustainable water and wastewater services.	The STIP is assessed on a calendar year basis. Awards are paid in cash with no deferral, other than for specific reasons, such as a performance metric not being finalised at the point of award. A clawback applies in the event that results on which the STIP is paid are subsequently found to be inaccurate or there has been relevant misconduct on the part of the employee.	The STIP is structured with three elements, determined by the Remuneration Committee: • up to 50% payable on financial targets; • up to 40% payable on balanced scorecard targets; and • up to 10% payable on performance against personal targets. The Chairman retains the right to award an additional discretionary bonus to the CEO, taking account of overall performance.	The maximum STIP payable, as a percentage of basic salary, is 70% for the CEO and 50% for the other Executive Directors.

table continued...

PURPOSE	OPERATION	PERFORMANCE ASSESSMENT	MAXIMUM PAYABLE
LTIP			
The purpose of the LTIP is to focus on key business metrics, engender a longer term view, encourage a one team approach, remain competitive in the executive market and encourage the retention of our key people.	The LTIP is a cash based award, with deferred payment. Vesting of the LTIP is based on performance in the first calendar year after award. Payment is deferred until the completion of four years from the start of the performance period.	The LTIP is payable on financial performance only, with 50% related to delivery of expected distributions to Group shareholders in line with the Board approved plan and 50% related to achievement of the Group profit after tax target. For each element, there will be no vesting if less than 97.5% of the target value is achieved, increasing on a sliding scale to 50% vesting if 100% of the target is achieved and 100% vesting if 105% of the target is achieved.	The maximum LTIP payable, as a percentage of basic salary, is 50% for the CEO and 30% for the other Executive Directors.
Pension			
Pension benefits are provided at a level to reflect market expectations.	The Company operates the Northumbrian Water Pension Scheme (NWPS) which has defined benefit and defined contribution sections. The defined benefit section closed to new entrants on 31 December 2007. More details of the NWPS are provided in note 23 of the Financial Statements.	There is no variable performance related element.	H Mottram left the NWPS at the start of the year and receives additional salary payments in lieu of pension contributions. C I Johns participates in the defined contribution section of the NWPS, making an employee contribution of 8% of basic salary (under a salary sacrifice arrangement) and receiving an employer contribution of 15% of salary, up to the annual pension contribution taxation limit, and additional salary payments in lieu of pension contributions. A C Jones participates in a defined benefit section, making an employee contribution of 8% of pensionable salary (under a salary sacrifice arrangement) and receiving an employer contribution equivalent to 22.1% of pensionable salary. Benefits are calculated on a career average revalued earnings (CARE) basis with future accrual at 1/45th of salary per annum.

ILLUSTRATION OF REMUNERATION POLICY

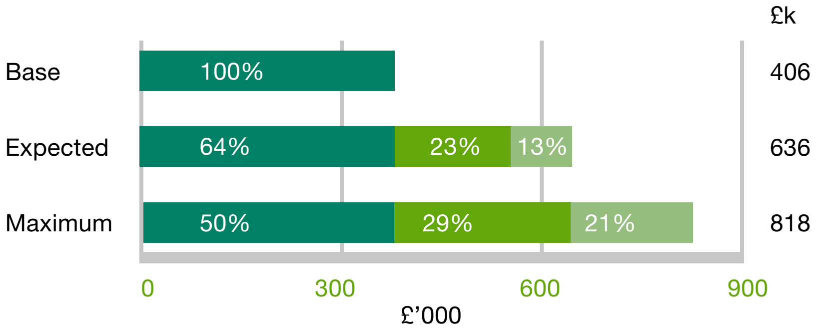
The graphs below show for each Executive Director:

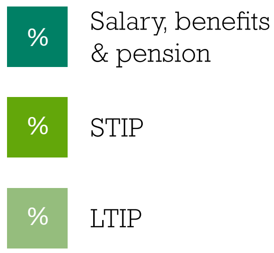
- the base level of remuneration, which is not dependent upon performance and comprises basic salary, benefits in kind and pension;
- the expected level of remuneration, reflecting a typical level of performance against targets for the STIP and LTIP; and
- the maximum level of remuneration, if all STIP and LTIP performance targets were fully achieved.

For the purposes of the graph, the expected level of performance for the STIP has been assumed to achieve 60% of the maximum potential value and the LTIP has been assumed to achieve 50% of the maximum value, though awards are dependent upon actual performance.

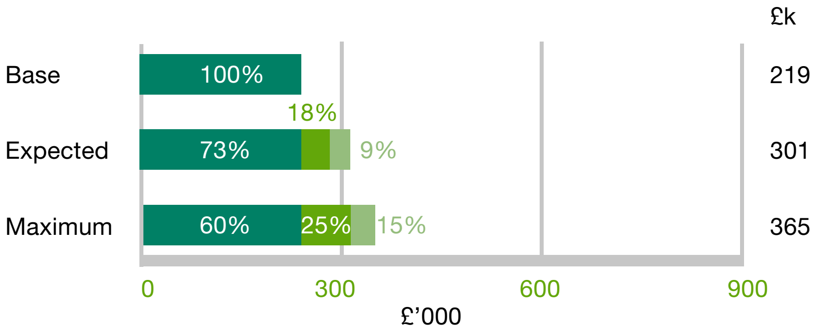
Information on actual awards for the STIP and LTIP in respect of 2016 is provided on pages 67 to 73.

H MOTTRAM

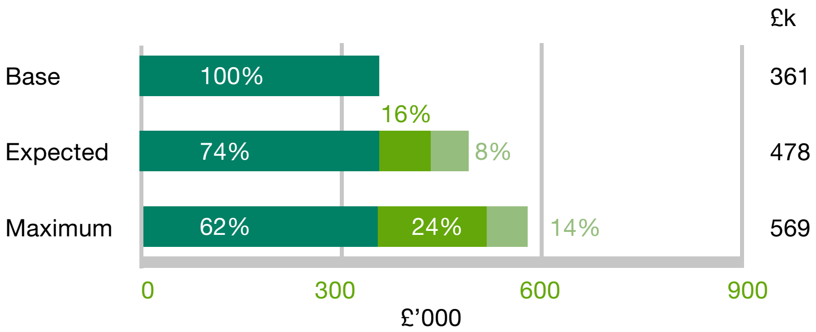




C I JOHNS



A C JONES



NON-EXECUTIVE DIRECTORS

FEES	OTHER COMPONENTS OF REMUNERATION	REMUNERATION ELSEWHERE IN THE GROUP
The Company's policy is that the Independent Non-Executive Directors receive fees for their duties. The level of fees is set by reference to the market. An additional fee is paid to the Chair of the Audit Committee to reflect the additional responsibilities and time commitment involved.	The Non-Executive Directors do not receive benefits in kind and do not participate in the STIP, LTIP or pension schemes operated by the Company.	The INEDs do not receive any other remuneration from the Company, the Group or its shareholders. In respect of the Non-Executive Directors appointed by the Group's shareholders, F R Frame receives the same base fee for performing his duties as a Director of both the Company and NWGL. This fee is shared with NWL paying a 30% proportion and NWGL paying the remaining 70%. The other Non-Executive Directors receive no remuneration from the Company.

SERVICE CONTRACTS

The service contracts of Executive Directors have a notice period of 12 months from either side, with the exception of A C Jones, who has a long-standing contractual arrangement requiring only 6 months notice from the employee and 12 months from the Company.

The contracts do not contain any specific provisions related to payment for loss of office. Any such payments would be at the discretion of the Remuneration Committee and would take account of the contractual notice period and any STIP payments considered to have been earned. LTIP awards will typically lapse, although the Remuneration Committee may approve payment of outstanding LTIP awards if a Director is considered to be a 'good leaver', for example upon retirement.

Non-Executive Directors are engaged on a contract for services with a notice period of 6 months from either side. No payment is made for loss of office other than accrued fees.

The Non-Executive Directors appointed by CKI and CKH do not have service contracts with the Company, and receive no payment from the Company.

APPROACH TO REMUNERATION ON RECRUITMENT

Newly appointed Directors are remunerated in accordance with the policy set out in this report.

CONSIDERATION OF SHAREHOLDER VIEWS

The Remuneration Committee comprises two shareholder-appointed Directors and three INEDs. In the context of a private company with a single ultimate controlling shareholder, this ensures that the views of the shareholder are taken into account when setting executive remuneration, whilst also maintaining a strong independent presence on the Committee.

CONSIDERATION OF EMPLOYMENT CONDITIONS ELSEWHERE IN THE COMPANY

The Remuneration Committee reviews Directors' pay on an annual basis, taking account of market trend information and pay awards for the wider workforce in the Company. Whilst Directors' remuneration is not specifically consulted on with employees, in general, annual pay awards for Directors reflect the target pay awards for the workforce, which are subject to consultation under the Company's employee relations framework. The incentive pay arrangements for executives are not mirrored elsewhere, but are considered to be relatively modest in comparison with market comparisons.

Directors' remuneration packages are benchmarked against market data on a periodic basis, typically every three years, with support from external advisers. The salary benchmarking is reviewed annually for senior managers and every three years for the wider workforce.

DIRECTORS' REMUNERATION IN 2016/17 (AUDITED)

The table below shows the total remuneration paid by the Company to Directors during the year, along with comparative information for the previous year. The table has been produced in accordance with the requirements of Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

	SALARIES AND FEES £'000		BENEFITS IN KIND £'000		STIP £'000		LTIP £'000		PENSION £'000		TOTAL REMUNERATION £'000	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
H Mottram	350	344	9	9	210	210	126	102	39	41	734	706
C I Johns	180	177	9	9	67	41	40	32	25	28	321	287
A C Jones	264	267	16	14	95	58	57	41	75	266	507	646
M Fay	45	43		-		-		-		-	45	43
F R Frame	14	13		-		-		-		-	14	13
Dr S Lyster	45	43		-		-		-		-	45	43
M A B Nègre	45	43		-		-		-		-	45	43
P Rew	60	55		-		-		-		-	60	55
	1,003	**985**	**34**	**32**	**372**	**309**	**223**	**175**	**139**	**335**	**1,771**	**1,836**

The table shows only the proportion of remuneration borne by the Company. For two of the Directors, H Mottram and C I Johns, NWL pays 70% of their remuneration and NWGL pays the remaining 30%. For F R Frame, NWL pays 30% of his remuneration and NWGL pays the remaining 70%. For the other Directors reported in the table, NWL pays 100% of their remuneration.

H Mottram and C I Johns receive salary payments in lieu of employer pension contributions. For consistency with prior years, these have been reported as pension costs.

BASIC SALARY

Basic salary is set by reference to market data and trends.

For the calendar year 2016, senior executives were awarded an annual increase in their basic salaries of 1.5%, which was less than the level awarded to most employees.

For the calendar year 2017, senior executives were awarded an annual increase in their basic salaries of 2%, which was the same as the level awarded to most employees.

BENEFITS

Taxable benefits provided to the Executive Directors comprise car and fuel allowance, healthcare and professional subscriptions. The values are not significant in the context of overall remuneration.

STIP

The STIP for the 2016 calendar year was structured by the Committee in accordance with the policy outlined above, as follows:

- up to 50% payable on Balanced Scorecard financial targets;
- up to 40% payable on Balanced Scorecard non-financial targets; and
- up to 10% payable on performance against personal targets.

The Balanced Scorecard measures and targets, and performance against the targets in the year, are shown in the table below. These targets are internal measures set at stretching levels so as to drive year on year performance improvements on a path to deliver our 'national leader' vision. This means that they are often more stretching than the regulatory Performance Commitments reported in the Performance section on page 16 to 17.

SCORECARD MEASURE	2016/17 TARGET	2016/17 PERFORMANCE	ACHIEVED	% OF TOTAL AWARDED	% OF TOTAL STIP POTENTIAL
Customer					
Customer satisfaction					
- SIM qualitative score	>=4.7	4.55	no	2	3
- SIM quantitative score	<=80	79.8	yes	0.5	1
Water supply interruptions >3 hours (average minutes per property)	<=4.00	2.26	yes	4	4
Mean zonal compliance	>=99.97	99.93	no	-	4
Repeat sewer flooding (properties)	<=96	46	yes	4	4
Environment					
Leakage (Mld)					
- NW	<=127	134	no	-	2
- ESW	<=61.8	68	no	-	2
Pollution incidents category 1 & 2	<=1	9	no	-	4
STW failing LUT consent (%)	0	1	no	-	4
Competitiveness					
Group EBIT	budget	achieved	yes	25	25
Group cash available for distribution	budget	achieved	yes	25	25
People					
Employee engagement score	>=81%	74%	no	-	4
Lost time reportable accidents (no.)	<=3	9	no	-	4
Communities					
BITC Platinum Plus	retain	retained	yes	4	4
Total STIP related to Balanced Scorecard				64.5	90

In respect of the 10% of STIP related to personal targets, the individual targets were as follows:

- H Mottram had targets including delivering expected financial performance, retention of existing credit ratings, delivery of outstanding customer service, ensuring business readiness for the opening of the non household retail market, a wider set of KPIs relating to a Balanced Scorecard of targets and leadership and delivery of the Company's Business Plan;
- C I Johns had targets including delivering expected financial performance, retention of existing credit ratings, implementing new financial reporting standards across all Group companies and successfully implementing a Group restructuring; and
- A C Jones had targets including the development of a collaborative working culture with our asset delivery partners in support of capital efficiency targets, overseeing the development and implementation of a behavioural safety programme, engagement with Ofwat's Water 2020 programme and commencement of preparations for the PR19 price review.

A number of these targets related to NWL's performance as a relevant undertaker. In assessing overall performance, the Committee takes into account the Company's position in Ofwat reports.

For the CEO, in addition to the STIP calculation explained above, a further discretionary award was made by the Committee to reflect the Board's continued satisfaction with the CEO's performance. This remained within the limit of the overall potential maximum STIP award.

The total STIP awards for 2016 were as follows:

	STIP awarded (out of 100%)	MAXIMUM STIP (% OF BASIC SALARY)	STIP AWARDED (% OF BASIC SALARY)
H Mottram	89.1%	70%	62.4%
C I Johns	74.5%	50%	37.3%
A C Jones	74.5%	50%	37.3%

LTIP

A cash LTIP was awarded by the Committee in 2016, structured in accordance with the policy outlined above, as follows:

- up to 50% payable on achievement of the Group profit after tax target; and
- up to 50% payable on delivery of expected distributions to Group shareholders.

The scheme related to the period January 2016 to December 2019. Performance targets were assessed in the first year of the scheme with payment deferred until early 2020, after the end of the four year scheme period.

The Committee assessed the performance against the scheme criteria in February 2017. In respect of Group profit performance the full 50% available vested and for Group distributions 25% of the 50% available vested.

The Committee therefore approved that the 2016 LTIP should vest at 75%. This is not dependent upon any future performance conditions being met.

The total LTIP awards for 2016 were as follows:

	LTIP awarded (out of 100%)	MAXIMUM LTIP (% OF BASIC SALARY)	LTIP AWARDED (% OF BASIC SALARY)
H Mottram	75%	50%	37.5%
C I Johns	75%	30%	22.5%
A C Jones	75%	30%	22.5%

PENSION

Pension arrangements operated in accordance with the policy outlined on page 71.

A C Jones is a member of the defined benefit section of the NWPS, therefore the pension value shown in the table above has been calculated in accordance with the 2013 Regulations and represents the estimated increase in the capital value of his pension in the year. The value in the prior year was atypically high as it reflected a salary review conducted by the Remuneration Committee during 2015 which reflected the increase in his responsibilities in relation to the asset management process and capital efficiency targets.

PERCENTAGE CHANGE IN CEO REMUNERATION

The table below shows the change in remuneration for 2016/17 compared to 2015/16 for the CEO and for other employees. In order to make a meaningful comparison, other employees includes only those who have been employed for the full two year period and excludes senior management whose remuneration is set by the Remuneration Committee. STIP has been compared to the annual bonus paid to the senior management cohort.

	CHANGE IN CEO REMUNERATION	CHANGE IN OTHER EMPLOYEES' REMUNERATION
Salaries and fees	1.7%	3.6%
Benefits in kind	2.3%	14.6%
STIP / annual bonus	0.0%	(7.6%)

CEO REMUNERATION OVER TIME

Since the current remuneration policy was put in place in 2012, the basic salary of the CEO has increased by the same, or less than, the average pay award for the majority of employees each year, which has been targeted to ensure we keep pace with the general cost of living. Over the same period, the maximum potential bonus available under the STIP and LTIP has remained a constant proportion of salary and the actual bonuses awarded have increased year on year by less than 2%.

RELATIVE IMPORTANCE OF SPEND ON PAY

The table below shows total staff costs and dividends paid for the current and prior years, and the year on year change.

	2017	2016	CHANGE
Staff costs (note 6)	134.0	129.9	3.2%
Dividends (note 9)	212.5	211.0	0.7%

IMPLEMENTATION OF REMUNERATION POLICY IN 2017/18

There have been no changes made by the Committee to the remuneration policy to be implemented in 2017/18, other than the change to the Group financial targets in the STIP and LTIP to exclude any impact from the performance of NWGB. This reflects the opening of the NHH Retail market in April 2017, and the need for the NWL wholesale business to operate demonstrably at arms length from NWGB, and ensures that NWL Directors do not benefit from the performance of NWGB.

STIP

The Balanced scorecard targets for 2017/18 are shown in the table overleaf These are internal measures set at stretching levels so as to drive year on year performance improvements on a path to deliver our 'national leader' vision. This means that they are often more stretching than the regulatory Performance Commitments reported in the Performance section on pages 16 to 17.

SCORECARD MEASURE	2017/18 TARGET	%OF TOTAL STIP POTENTIAL
Customer		
Customer satisfaction		
- SIM qualitative score	>=4.65	3
- SIM quantitative score	<=85	1
Water supply interruptions >3 hours (average minutes per property)	<=3.55	4
Mean zonal compliance	>=99.97	4
Repeat sewer flooding (properties)	<=71	4
Environment		
Leakage (Mld)		
- NW	<=130	2
- ESW	<=60	2
Pollution incidents category 1 & 2	<=1	4
STW failing LUT consent (%)	0	4
Competitiveness		
Group EBIT	budget	25
Group cash available for distribution	budget	25
People		
Employee engagement score	>=79%	4
Lost time reportable accidents (no.)	<=3	4
Communities		
BITC Platinum Plus	retain	4
Personal targets		10

Personal targets for 2017 have been set as follows:

- H Mottram has targets including delivering expected financial performance, retention of existing credit ratings, delivery of outstanding customer service, a wider set of KPIs relating to a Balanced Scorecard of targets and leadership and delivery of the Company's Business Plan;
- C I Johns has targets including delivering expected financial performance, retention of existing credit ratings, working with HMRC to finalise open years' tax computations and assessing and responding to the impacts of changes in tax legislation; and
- A C Jones has targets including delivering an integrated asset planning and delivery operating model, directing the Leading Asset Management programme, overseeing the development and implementation of a behavioural safety culture programme and leading our PR19 Business Plan approach and Board engagement.

DIRECTORS' REPORT

DIRECTORS

The Directors who served during the year are listed on pages 51 to 53 of the Governance Report.

DISCLOSURES PROVIDED IN THE STRATEGIC REPORT

Future developments which may impact on the Company are described in the CEO's Report.

Our approach to innovation is described in the Performance section of our Strategic Report under the Competitiveness heading and the costs of research and development are disclosed in note 4 of the Financial Statements.

Our policies in respect of the employment for disabled persons and employee involvement are set out in the Performance section of our Strategic Report under Diversity and Equal opportunities on page 33.

Information on results and dividends is contained in the Financial Performance and Structure section of the Strategic Report. Our policies in relation to the use of financial instruments and treasury operations are set out in the same section under the 'Treasury policies' heading.

POST BALANCE SHEET EVENT

On 2 March 2017, the Secretary of State for the Environment confirmed that the competitive water retail market for business, charities and public sector customers (together referred to as NHH customers) would open on 1 April 2017. Ahead of this, NWL had applied for, and been granted, permission to exit the NHH retail market at 1 April 2017 and transfer the associated NHH retail business to an acquiring licenced retailer, NWGB, another subsidiary of NWGL.

The transfer of business took effect on 1 April 2017, after the balance sheet date, in accordance with a Statutory Transfer Scheme (STS) approved by Ofwat. Under the STS, the NHH business, NHH customers and related special agreements were transferred to NWGB, along with outstanding debtor balances, the right to unbilled income and certain tangible fixed assets. Further information is disclosed in note 2 of the financial statements.

POLITICAL DONATIONS

NWL does not support any political party and we do not, directly or through any subsidiary, make what are commonly regarded as donations to any political party or other political organisation. However, the wide definition of donations in the Political Parties, Elections and Referendums Act 2000 covers activities which form part of the necessary relationship between the Company and political parties and political organisations. These activities include attending party conferences, as these provide the best opportunity to meet a range of stakeholders, both national and local, to explain our activities, as well as local meetings with MPs, MEPs and their agents. During the year, no external costs were associated with these activities, however, Company representatives attended the party conferences of the Labour and Conservative parties.

GREENHOUSE GAS EMISSIONS

Our carbon management plan has the aim of reducing our GHG emissions by 35% by 2020 against a 2008 baseline. We have almost achieved this target, having reduced emissions through our own efforts by 30% compared to the baseline, with a further 8% reduction resulting from a lower emissions factor for grid electricity. The protocol that we use for measuring our emissions is based on the Carbon Accounting Workbook developed and updated annually by the Water Research Council, on behalf of the water industry, and published by UK Water Industry Research. This is founded on international and DEFRA protocols but includes additions that are specific to the water industry.

Our total net operational GHG emissions for the year ended 31 March 2017 reduced to 187.7 ktonnes CO_2e (31 March 2016: 225.2 ktonnes CO_2e), reflecting a reduction in energy usage of 2% together with a 11% reduction in the emissions factor applied for grid electricity. The reduction in usage was largely driven by an extended period of dry weather across our operating regions reducing wastewater usage, though this was partially offset by the need to carry out more transfers of water resources and utilise more energy intensive treatment works.

We also now routinely inject biomethane into the national grid, as described on page 28, which contributes to the long term sustainability of the UK's gas supply. This has also contributed to the reduction in emissions as this can now be used to offset imports in the calculation of net GHG emissions.

In addition to absolute emissions we also monitor the emissions intensity of our operations using three measures, one relating to the water service and two for wastewater. As described above, these measures can be volatile depending upon levels of rainfall and pumping requirements, therefore we focus on longer term trends.

ANNUAL OPERATIONAL GHG INTENSITY RATIO	2016/17	2015/16
Emissions/Ml of water	227	239
Emissions/Ml of sewage treated (flow to full treatment)	252	319
Emissions/Ml of sewage treated (water distribution input)	452	607

Figures in kgCO_2e/Ml

DIRECTORS' INDEMNIFICATION

NWGL had Directors' and Officers' insurance in place for the year to 31 March 2017. On 21 March 2017 NWGL entered into a deed of indemnity to grant the Directors of NWGL and its subsidiaries further protection against liability to third parties, subject to the conditions set out in the Companies Act 2006, and this remains in place.

DIRECTORS' STATEMENT

As required under s418 of the Companies Act 2006, so far as each current Director is aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

AUDITOR

Pursuant to s487 of the Companies Act 2006, Deloitte LLP is deemed to be re-appointed as the Company's auditor for the ensuing year.

FINANCIAL STATEMENTS PREPARATION AND GOING CONCERN

The Directors confirm that, in their opinion, the Company has sufficient financial resources and facilities available to enable it to carry out its activities for at least the next 12 months. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements. In arriving at their decision, the Directors have taken into account:

- the financial strength of the Company at the balance sheet date and financial performance, which is in line with expectations and reviewed at each Board meeting, most recently in May 2017;
- the key financial ratios over the next 12 month planning horizon, as reflected in strong investment grade credit ratings;
- the fact that the Company has in place £350m of five year committed bank facilities as back up liquidity (maturing in 2019), and a further £100m of committed financing from the EIB, both of which were undrawn at 31 March 2017; and
- the Company's formal governance and risk management arrangements which are monitored by the Audit Committee, Risk & Compliance Committee and Board.

VIABILITY STATEMENT

The Directors believe that the Company is well placed to manage its business risks and expect that the business can continue to operate effectively over the long term and, specifically, meet its financial obligations over the five years to March 2022. In arriving at their opinion, the Directors have taken into account:

- the Licence which is in place on a rolling 25 year basis;
- the certainty on wholesale and household retail price controls to March 2020 provided by the 2014 Final Determination by Ofwat, following its acceptance by the Board;
- the financial strength of the Company at the balance sheet date and the fact that the Company has a £350m five year committed bank facility as back up liquidity (maturing in 2019), and a further £100m of committed financing from the EIB, both of which were undrawn at 31 March 2017;
- the key financial ratios over the planning horizon of the Company's medium term plan to March 2022 as reflected in strong investment grade credit ratings;
- the Board's flexible dividend policy; and
- the principal risks and uncertainties facing the Company and the mitigating controls, as described on pages 43 to 47, which are monitored by the Audit Committee, Risk & Compliance Committee and Board.

The Directors have chosen a period of five years to March 2022 to assess the viability of the Company after taking account of the stable nature of the regulated water industry and the increasing visibility provided by Ofwat of the next regulatory price review.

The medium term plan has been stress tested under a number of adverse, but possible, scenarios which would directly impact on the Company's financial model, in the context of the Company's financial objective of retaining a strong investment grade credit rating. The scenarios tested included: a sustained period of lower RPI; increased interest rates for future borrowings; increased current tax charges; failure to deliver totex efficiency targets; a deterioration in the defined benefit pension scheme deficit and lower than expected returns at the next price review.

To the extent that any of these scenarios, in isolation or combination, would place retention of the Company's credit rating at risk, the Directors are confident that this could be mitigated by application of the Board's flexible dividend policy alongside targeted management actions. Separate third party assurance agreed upon procedures have been performed on the calculations and stress testing of the plan in order to provide independent assurance to the Directors of the impact of the various scenarios.

FAIR, BALANCED AND UNDERSTANDABLE

The Directors consider that the annual report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for stakeholders to assess the Company's performance, business model and strategy. In reaching this conclusion, the Board has taken advice from the Audit Committee which has considered the process by which the report and financial statements has been produced as well as reviewing and commenting on the report.

DIRECTORS' RESPONSIBILITIES STATEMENT

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom (UK) Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including FRS 101 Reduced Disclosure Framework. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

MParker

M Parker
Company Secretary,
14 July 2017

Registered office
Northumbria House, Abbey Road, Pity Me, Durham, DH1 5FJ

Registered in England and Wales
Registered no: 02366703

FINANCIAL STATEMENTS

INCOME STATEMENT

FOR THE YEAR ENDED 31 MARCH 2017

	NOTE	2017 £'m	2016 £'m
Continuing operations			
Revenue	3	821.6	805.5
Operating costs (including exceptional operating items)	4	(464.7)	(432.8)
Operating profit		**356.9**	**372.7**
Finance costs	7	(136.6)	(106.3)
Profit before taxation		**220.3**	**266.4**
Taxation	8(a)	(19.0)	(3.5)
Profit for the year attributable to the shareholder of the Company		**201.3**	**262.9**

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 MARCH 2017

	NOTE	2017 £'m	2016 £'m
Profit for the year		201.3	262.9
Items that will not be reclassified subsequently to profit and loss:			
Actuarial losses	23	(71.7)	(49.5)
Deferred tax related to actuarial losses	8(b)	10.9	7.6
Items that may be reclassified subsequently to profit and loss:			
Profit / (losses) on cash flow hedges taken to equity		4.2	(15.9)
Tax on items charged to equity that may be reclassified		(1.0)	2.9
Other comprehensive loss		**(57.6)**	**(54.9)**
Total comprehensive income for the year attributable to the shareholder of the Company		**143.7**	**208.0**

BALANCE SHEET

AT 31 MARCH 2017 (REGISTERED NUMBER 02366703)

	NOTE	2017 £'m	2016 £'m
Non-current assets			
Property, plant and equipment	10	4,260.5	4,169.6
Financial investments	11	160.9	160.9
		4,421.4	**4,330.5**
Current assets			
Inventories	12	2.8	2.4
Trade and other receivables	13	161.0	185.7
Asset held for resale	14	42.4	-
		206.2	**188.1**
Total assets		**4,627.6**	**4,518.6**
Current liabilities			
Trade and other payables	15	(170.2)	(158.0)
Borrowings	16	(268.1)	(96.8)
Obligations under finance leases	17(a)	(56.2)	(8.5)
Provisions	18	(0.2)	(0.2)
		(494.7)	**(263.5)**
Non-current liabilities			
Borrowings	16	(2,378.8)	(2,447.8)
Obligations under finance leases	17(a)	(53.0)	(101.2)
Provisions	18	(1.2)	(1.4)
Deferred tax liabilities	8(d)	(375.5)	(404.7)
Pension liability	23	(153.1)	(89.9)
Hedging instruments	20	(39.6)	(31.3)
Other payables		(0.2)	-
Grants and deferred income	19	(533.3)	(511.8)
		(3,534.7)	**(3,588.1)**
Total liabilities		**(4,029.4)**	**(3,851.6)**
Net assets		**598.2**	**667.0**
Capital and Reserves			
Share capital	21	122.7	122.7
Cash flow hedge reserve		(21.0)	(24.2)
Profit and loss account		496.5	568.5
Equity attributable to the shareholder of the Company		**598.2**	**667.0**

H Mottram

Approved by the Board of Directors on 14 July 2017 and signed on their behalf by: **H Mottram**

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2017

	NOTE	SHARE CAPITAL £'m	CASH FLOW HEDGE RESERVE £'m	RETAINED EARNINGS £'m	TOTAL EQUITY £'m
At 1 April 2015		**122.7**	**(11.2)**	**558.5**	**670.0**
Profit for the year		-	-	262.9	262.9
Other comprehensive income and expense		-	(13.0)	(41.9)	(54.9)
Total comprehensive income and expense for the year		-	(13.0)	221.0	208.0
Dividends	9	-	-	(211.0)	(211.0)
At 31 March 2016		**122.7**	**(24.2)**	**568.5**	**667.0**
Profit for the year		-	-	201.3	201.3
Other comprehensive income and expense		-	3.2	(60.8)	(57.6)
Total comprehensive income and expense for the year		-	3.2	140.5	143.7
Dividends	9	-	-	(212.5)	(212.5)
At 31 March 2017		**122.7**	**(21.0)**	**496.5**	**598.2**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2017

1. ACCOUNTING POLICIES

NWL is incorporated in the United Kingdom under the Companies Act. The Company is a private Company limited by shares and is registered in England and Wales. The address of the Company's registered office is shown on page 79. The nature of the Company's operations and its principal activities are set out in the Strategic Report on pages 3 to 47.

These Financial Statements are presented in sterling and all values are rounded to the nearest one hundred thousand pounds (£0.1m) except where otherwise indicated.

These Financial Statements are separate financial statements. The Company is exempt from the preparation and delivery of consolidated financial statements, because it is included in the Group Financial Statement of NWGL (link to page 107).

(a) BASIS OF ACCOUNTING

These Financial Statements have been prepared in accordance with FRS 101, incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, presentation of a cash flow statement, standards not yet effective and related party transactions.

The Financial Statements have been prepared under the historical cost convention, with the exception of financial instruments held at fair value through profit and loss.

The Financial Statements have been prepared on a going concern basis, having considered the principal risks and uncertainties, which assumes that the Company will have adequate funding to meet its liabilities as they fall due in the foreseeable future. As at 31 March 2017, the Company had net current liabilities of £288.5m (2016: £75.4m). The Directors have reviewed cash flow requirements and are confident that they will be able to meet these from funds available, including the undrawn committed bank facilities of £350m (2016: £350m) and the £100m committed EIB funding. Accordingly, the Directors believe it is appropriate to prepare the financial statements on a going concern basis.

(b) REVENUE

Revenue, which excludes Value Added Tax, represents the income receivable in the ordinary course of business for services provided within the United Kingdom. All water and sewerage charges billed to customers are recognised pro-rata over the period to which they relate. For consumption by measured customers which has not yet been billed, an accrual is estimated.

(c) CASH FLOW STATEMENT

As permitted by FRS 101, the Company has elected not to present a cash flow statement.

(d) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, including assets in the course of construction, comprise infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties, vehicles and above ground plant and equipment).

Purchased property, plant and equipment are included at cost less accumulated depreciation and any provision for impairment. Cost comprises the aggregate amount incurred and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended.

Where assets are constructed by a developer and adopted by NWL at no cost to the company, the assets are recognised in the balance sheet at their fair value on the date of the transfer and an equivalent value is recognised in deferred income, in accordance with IFRIC 18 Transfers of Assets from Customers. The fair value is based on the average cost to the Company of constructing an equivalent asset.

1. ACCOUNTING POLICIES (continued)

Freehold land is not depreciated. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Freehold buildings	30-60 years
Operational structures, plant and machinery	4-92 years
Infrastructure assets (see below)	4-200 years
Fixtures, fittings, tools and equipment	4-10 years

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable and are written down immediately to their recoverable amount. Useful lives and residual values are reviewed annually and, where adjustments are required, these are made prospectively.

Assets in the course of construction are not depreciated until commissioned.

Infrastructure assets

Infrastructure assets comprise a network of systems being mains and sewers, reservoirs, dams and sea outfalls.

Expenditure on infrastructure assets which enhances the asset base is treated as fixed asset additions while maintenance expenditure which does not enhance the asset base is charged as an operating cost.

Infrastructure assets are depreciated evenly to their estimated residual values over their estimated economic lives, which are principally as follows:

Dams and impounding reservoirs	150 years
Water mains	100 years
Sea outfalls	60 years
Sewers	200 years
Dedicated pipelines	4-20 years

(e) FINANCIAL INVESTMENTS

Financial investments are stated at their purchase cost, less provision for diminution in value (note 11).

(f) GRANTS AND CONTRIBUTIONS

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Revenue grants are credited to the income statement in the period to which they relate. Capital grants and contributions relating to property, plant and equipment are treated as deferred income and amortised to the income statement over the expected useful economic lives of the related assets.

Deferred income relating to assets adopted from developers, recognised in accordance with IFRIC 18, is amortised to the income statement over the expected useful economic lives of the related assets.

(g) HIRE PURCHASE AND LEASING

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership to the Company, the assets are treated as if they had been purchased at their fair value or, if lower, at the present value of the minimum lease payments. Rentals or leasing payments are treated as comprising a capital element and finance charges, the capital element reducing the outstanding liability and the finance charges being charged to the income statement over the period of the leasing contract at a constant rate on the reducing outstanding liability.

Rentals under operating leases (where the lessor retains a significant proportion of the risks and rewards of ownership) are expensed in the income statement on a straight line basis over the lease term.

(h) INVENTORIES

Inventories are stated at cost less any provision necessary to recognise damage and obsolescence.

(i) PENSION COSTS

The Company is the principal employer of the Northumbrian Water Pension Scheme (NWPS or the Scheme), which has both a defined benefit section and a defined contribution section.

The cost of providing benefits under the defined benefit section of the Scheme is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs, the obligation and related plan assets are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs. Net interest is calculated by applying the discount rate to the net defined asset or liability.

1. ACCOUNTING POLICIES (continued)

The service cost is disclosed in manpower costs and the net interest expense is disclosed within finance costs.

Actuarial gains and losses on experience adjustments and changes in actuarial assumptions are recognised in full in the period in which they occur in the statement of comprehensive income.

The costs of the defined contribution section are charged to the income statement in the period they arise.

(j) TAXATION

Current tax

Current tax liabilities are measured at the amount expected to be paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted, or substantively enacted, at the balance sheet date.

Deferred tax is recognised in the income statement, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity.

(k) FOREIGN CURRENCY

All transactions denominated in foreign currencies are translated into sterling at the actual rates of exchange ruling at the date of transaction. Foreign currency balances are translated into sterling at the rates of exchange ruling at the balance sheet date. Exchange gains or losses are recognised in the profit and loss account in the period incurred.

(l) RESEARCH AND DEVELOPMENT

Research and development expenditure is charged to the income statement in the period in which it is incurred.

(m) DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilises interest and inflation rate swaps, gilt locks and forward exchange contracts as derivative financial instruments.

A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Company in line with the Group's risk management policies. Derivative financial instruments are stated at their fair value.

Hedge accounting is employed in respect of those derivative financial instruments fulfilling the requirements for hedge accounting as prescribed under IAS 39. In summary, these criteria relate to

1. ACCOUNTING POLICIES (continued)

initial designation and documentation of the hedge relationship, prospective testing of the relationship to demonstrate the expectation that the hedge will be highly effective throughout its life and subsequent retrospective testing of the hedge to verify effectiveness.

Under IFRS 13, derivative financial instruments are measured at fair value, which is considered to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction reflecting the credit risk of the counterparties in the principal (or most advantageous) market under market conditions as at the balance sheet date.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swaps and inflation swaps are determined by reference to market values for similar instruments.

Hedging transactions undertaken by the Company are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges where they hedge exposure to variability in currency cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in the income statement.

In relation to cash flow hedges to hedge firm currency commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in the cash flow hedge reserve and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in the cash flow hedge reserve are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in the cash flow hedge reserve are transferred to the income statement in the same periods in which the hedged firm commitment affects the income statement.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in the cash flow hedge reserve is kept in the cash flow hedge reserve until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in the cash flow hedge reserve is transferred to the income statement.

(n) INTEREST BEARING LOANS AND BORROWINGS

All loans and borrowings are initially stated at the amount of the net proceeds, being fair value of the consideration received net of issue costs associated with the borrowing. Finance costs (including issue costs) are taken to the income statement over the term of the debt at a constant rate on the balance sheet carrying amount. The carrying amount is increased by the finance charges amortised and reduced by payments made in respect of the accounting period. The carrying amount of index linked borrowings increases annually in line with the relevant RPI, with the accretion being charged to the income statement as finance costs payable. Other borrowing costs are recognised as an expense when incurred.

Realised gains and losses that occur from the early termination of loans and borrowings are taken to the income statement in that period.

Net debt is the sum of all loans and borrowings less cash and cash equivalents, short term cash deposits, financial investments and loans receivable.

(o) BAD DEBT PROVISIONING

The bad debt provision is calculated by applying a range of percentages to debt of different ages. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age.

(p) BORROWING COSTS

Borrowing costs are generally expensed as incurred. Borrowing costs that are directly attributable to the acquisition or construction of an asset that necessarily takes a substantial time to prepare for its intended use are capitalised while the asset is being constructed as part of the cost of that asset.

Capitalisation ceases when the asset is substantially ready for its intended use or sale. If active development is interrupted for an extended period, capitalisation is suspended. When construction occurs piecemeal, and use of each part ceases upon

1. ACCOUNTING POLICIES (continued)

substantial completion of that part, a weighted average cost of borrowings is used.

The Company capitalises borrowing costs for all eligible assets when construction commenced on or after 1 April 2009 and continues to expense borrowing costs relating to construction projects that commenced prior to that date.

(q) SIGNIFICANT ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the accounting policies, the Company is required to make certain judgements, estimates and assumptions that it believes are reasonable based on the information available. Actual results may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The significant accounting judgements were:

- the estimation of income for measured water and sewerage services supplied but not billed at the end of the financial period. Consumption by measured customers is billed periodically in arrears with large commercial customers being billed monthly and smaller commercial customers and domestic customers being billed on quarterly or six-monthly cycles. Revenue is estimated and accrued using a defined methodology based upon historical usage and the relevant tariff per customer;
- the estimation of uncertain tax provisions, which are assessed on advice from independent tax advisers and the status of ongoing discussions with the relevant tax authorities; and
- the asset lives assigned to property, plant and equipment, details of which can be found in note 1(d) above.

The significant accounting estimates were:

- those assumptions used in arriving at the defined benefit pension scheme assets and liabilities under IAS 19. These key assumptions and their possible impact are disclosed in note 23; and
- the bad debt provision, which is calculated by applying a range of percentages to debt of different ages, as described on note 1(o) above. These percentages also vary between different categories of debt. Higher percentages are applied to those categories of debt which are considered to be of greater risk and also to debt of greater age. The value of the bad debt provision is sensitive to the specific percentages applied.

2. POST BALANCE SHEET EVENT

On 2 March 2017, the Secretary of State for the Environment confirmed that the competitive water retail market for business, charities and public sector customers (together referred to as NHH customers) would open on 1 April 2017. Ahead of this, NWL had applied for, and been granted, permission to exit the NHH retail market at 1 April 2017 and transfer the associated NHH retail business to an acquiring licenced retailer, NWGB, another subsidiary of NWGL.

The transfer of business took effect on 1 April 2017, after the balance sheet date, in accordance with a Statutory Transfer Scheme (STS) approved by Ofwat. Under the STS, the NHH business, NHH customers and related special agreements were transferred to NWGB, along with outstanding debtor balances, the right to unbilled income and certain tangible fixed assets. NWGB paid an initial consideration of £45m for these assets and made a net additional payment of £0.5m to NWL once final balances were agreed. This resulted in a final valuation of £45.5m, including £3.1m in respect of goodwill.

The assets within the scope of the STS have been reclassified in the balance sheet as ‘Assets held for resale’. Further detail on this is provided in note 14.

NWL will continue to provide wholesale water and wastewater services to NHH properties in its areas of supply, through their licenced retailers, and continues to provide both wholesale and retail services to household customers.

3. SEGMENTAL INFORMATION

The Directors consider that the Company has one class of business, the provision of water and sewerage services. All revenue is generated from within the United Kingdom.

4. OPERATING COSTS

	NOTE	2017 £’m	2016 £’m
Materials and consumables		20.1	21.0
Manpower costs	6	134.0	129.9
Own work capitalised		(36.2)	(36.3)
Costs of research and development		0.9	0.8
Operating lease payments		1.5	1.2
Bad debt charge		10.9	18.8
Other operating costs		220.0	216.1
Depreciation of property, plant and equipment		130.5	126.0
Amortisation of capital grants		(5.7)	(5.4)
Profit on disposal of property, plant and equipment		(0.6)	(0.4)
Total operating costs prior to exceptional items		**475.4**	**471.7**
Exceptional pension curtailment		-	(38.9)
Exceptional business rates credit		(10.7)	-
Total		**464.7**	**432.8**

4. OPERATING COSTS (continued)

At the balance sheet date, the Company had an outstanding appeal against the rateable value for water business rates, as published on the 2005 Central List by the Valuation Office Agency (VOA). After the balance sheet date, the VOA responded to the Company's submitted arguments and proposed a revised valuation, which the Company accepted. The Company, with support of its professional advisors, calculated that the revised valuation will result in a refund of £10.7m, plus interest. This has been recognised in the Financial Statements as an exceptional credit.

The prior period includes an exceptional credit of £38.9m for pension curtailment. This related to changes made to future benefits from the defined benefit section of the NWPS, after consultation with employees.

Auditor's remuneration in respect of the statutory audit amounted to £131k (2016: £138k), including fees for a subsidiary, Northumbrian Water Finance plc (NWF), of £5k (2016: £6k). Fees of £54k (2016: £67k) were incurred in respect of the APR, including the audit of the Regulatory Accounting Statements, and agreed upon procedures in respect of additional regulatory information, the statement of sufficiency of financial resources and facilities and financial resilience stress testing.

Fees of £163k (2016: £75k) were incurred for non-audit services comprising tax advice and assurance work in respect of: the implementation of a new customer billing system; the NHH market entry assurance process; the wholesale non-primary charges scheme; a bond issue; and other assurance to third parties.

5. DIRECTORS' EMOLUMENTS

(a) Directors' remuneration

The remuneration of the Directors of the Company was as follows:

	2017 £'000	2016 £'000
Emoluments (including benefits in kind)	1,771	1,836

For those Directors holding office with both NWL and NWGL, or contributing significantly to the day to day operations of NWGL, costs are apportioned between the companies to reflect the level of activity carried out for each company. This note reflects only the proportion of costs charged to NWL.

One of the Directors at 31 March 2017 was a member of a defined benefit section of the Scheme where the Company makes contributions towards the cost (2016: 1).

One of the Directors at 31 March 2017 was a member of a defined contribution section of the Scheme where the Company makes contributions towards the cost (2016: 2).

The Directors' remuneration policy and a detailed report showing total remuneration for each Director, for the year to 31 March 2017, are set out in the Remuneration Committee Report on pages 63 to 73 of the Governance Report.

(b) Highest paid Director

The amounts for remuneration shown in note 5(a) include the following in respect of the highest paid Director:

	2017 £'000	2016 £'000
Emoluments (including benefits in kind)	734	706

The highest paid Director left the defined contribution section of the NWPS at the beginning of the year ended 31 March 2017, therefore no payments were made to The Scheme in the year (2016: £35k).

6. EMPLOYEE INFORMATION

The total employment costs of all employees (including Directors) were as follows:

	2017 £'m	2016 £'m
Gross costs charged to the profit and loss account:		
Wages and salaries	78.3	76.0
Social security costs	8.4	7.2
Other pensions costs	16.8	16.2
	103.5	**99.4**
Costs recharged to other Group companies:		
Wages and salaries	3.0	3.0
	3.0	**3.0**
Net costs charged to the profit and loss account:		
Wages and salaries	75.3	73.0
Social security costs	8.4	7.2
Other pensions costs	16.8	16.2
	100.5	**96.4**
Costs charged to capital schemes		
Wages and salaries	25.9	25.8
Social security costs	2.7	2.4
Other pensions costs	4.9	5.3
	33.5	**33.5**
Total net employee costs	**134.0**	**129.9**

The table above excludes the exceptional pension credit in the year ended 31 March 2016 (see note 4). The average monthly number of employees, including Directors, on the payroll during the financial year was 3,128 (2016: 3,125).

7. NET FINANCE COSTS

	2017 £'m	2016 £'m
Finance costs payable:		
Bank overdrafts and loans	14.5	17.3
Receivable in respect of derivatives	(2.0)	(0.9)
Payable to subsidiary Group company	95.7	88.7
Payable to other Group company	0.2	0.4
Amortisation of discount, fees, loan issue costs and other financing items	1.7	1.3
Accretion on index linked bonds	15.7	7.5
Interest cost on pension plan obligations	2.8	2.1
Obligations under finance leases	4.1	3.9
	132.7	**120.3**
Less amounts capitalised on qualifying assets	(5.2)	(5.4)
	127.5	**114.9**
Fair value losses on derivative financial instruments	12.5	1.4
Total finance costs payable	**140.0**	**116.3**

Finance income receivable:		
Bank deposits	(0.8)	(0.3)
Receivable from Group companies	(2.6)	(9.7)
Total finance costs receivable	**(3.4)**	**(10.0)**

Net finance costs payable	**136.6**	**106.3**

8. TAXATION

(a) Tax on profit on ordinary activities:

	2017 £'m	2016 £'m
Current tax:		
UK current income tax charge at 20% (2016: 20%)	14.1	8.2
Adjustments in respect of prior periods	0.1	(1.7)
Payable in respect of group relief for the year	24.7	25.6
Adjustments in respect of prior period group relief	(0.6)	1.2
Total current tax	**38.3**	**33.3**
Deferred tax:		
Origination and reversal of temporary differences in the year at 17% (2016: 18%)	4.5	16.5
Impact of reduction in rate of UK corporation tax	(24.2)	(46.6)
Adjustments in respect of prior periods	0.4	0.3
Total deferred tax	**(19.3)**	**(29.8)**
Tax charge in the income statement	**19.0**	**3.5**

The rate of corporation tax for the year has remained at 20%. Finance (No. 2) Act 2015 reduced the rate from 20% to 19% (with effect from 1 April 2017) and to 18% (with effect from 1 April 2020). The 2020 rate was further reduced to 17% by Finance Act 2016. Accordingly, deferred tax has been provided in line with the rates at which temporary differences are expected to reverse.

Tax losses have been provisionally claimed as group relief from other group companies, for which payment is being made at the full rate of tax. Tax losses have also been claimed as consortium relief from associated companies for which payment is being made at slightly less than the full rate of tax.

Although profit before tax has fallen compared to 2015/16, the current tax charge for the year has increased. This reflects one-off deductions received in 2015/16 in relation to the adoption of FRS101 and fair value losses on derivatives incurred in the current year that are not allowable for tax purposes, offset by an increase in deductions for pension contributions due to a spreading of the previous year's payments.

(b) Tax relating to items charged outside the income statement:

	2017 £'m	2016 £'m
Deferred tax:		
Actuarial gains and losses on pension scheme	(12.2)	(8.9)
Impact of reduction in rate of UK corporation tax	1.3	1.3
Financial instruments	0.7	(2.9)
Impact of reduction in rate of UK corporation tax	0.3	-
Tax credit in the statement of comprehensive income	**(9.9)**	**(10.5)**

8. TAXATION (continued)

(c) Reconciliation of the tax charge:

	2017 £'m	2016 £'m
Profit on ordinary activities before tax	**220.3**	**266.4**
Profit on ordinary activities multiplied by standard rate of corporation tax of 20% (2016: 20%)	44.1	53.3
Effects of:		
Expenses not deductible for tax purposes	0.4	0.1
Non-taxable income and other tax reliefs	(1.4)	(1.6)
Depreciation in respect of non-qualifying items	1.0	1.0
Permanent differences on transition to IFRS	-	0.6
Consortium relief payable at less than the standard rate	(0.5)	(1.9)
Impact on deferred tax of change in current tax rate	(24.2)	(46.6)
Deferred tax movement not at average rate for the year	(0.8)	(1.8)
Adjustments in respect of prior periods	0.4	0.4
Transfer pricing adjustments	(0.9)	(0.8)
Balancing payment payable	0.9	0.8
Total tax charge	**19.0**	**3.5**

(d) Deferred tax:

	ACCELERATED TAX DEPRECIATION £'m	DEFERRED INCOME £'m	RETIREMENT BENEFIT OBLIGATIONS £'m	FAIR VALUE HEDGING INSTRUMENTS £'m	BUSINESS COMBINATIONS £'m	OTHER £'m	TOTAL £'m
At 1 April 2015	**512.8**	**(58.9)**	**(18.2)**	**(2.8)**	**6.9**	**5.2**	**445.0**
Charge/(credit) in the income statement	(39.5)	4.9	5.5	(0.3)	(0.8)	0.4	(29.8)
Charge/(credit) in other comprehensive income	-	-	(7.6)	(2.9)	-	-	(10.5)
At 31 March 2016	**473.3**	**(54.0)**	**(20.3)**	**(6.0)**	**6.1**	**5.6**	**404.7**
Charge/(credit) in the income statement	(18.5)	(0.7)	1.9	(2.1)	(0.5)	0.6	(19.3)
Charge/(credit) in other comprehensive income	-	-	(10.9)	1.0	-	-	(9.9)
At 31 March 2017	**454.8**	**(54.7)**	**(29.3)**	**(7.1)**	**5.6**	**6.2**	**375.5**

8. TAXATION (continued)

(e) Factors that may affect future tax charges:

The Company expects to continue to incur high levels of capital expenditure during the remainder of the 2015-20 regulatory review period which, under current tax legislation, should result in claims for tax reliefs in excess of depreciation.

It is expected that new rules will be introduced with effect from 1 April 2017 to determine the amount of interest that companies can deduct for UK corporation tax purposes. Although the Company's financial statements contain significant amounts of finance costs, the new rules are not expected to have a material on its tax position.

9. DIVIDENDS

	2017 £'m	2016 £'m
Equity:		
Dividends paid:		
Interim paid for the year ended 31 March 2017 of 86.42p (year ended 31 March 2016: 85.61p) per share on an aggregated basis	106.0	105.0
Interim paid for the year ended 31 March 2017 of 86.83p (year ended 31 March 2016: 86.42p) per share on an aggregated basis	106.5	106.0
Total dividends paid in the year	**212.5**	**211.0**
Dividends proposed:		
Special dividend proposed for the year ended 31 March 2018 of 15.41p (year ended 31 March 2017: nil) per share on an aggregated basis	18.9	-

No final dividend was proposed for the year ended 31 March 2017 (2016: nil).

The Directors have a policy which aims to grow dividends on a slow but regular basis and which takes into account the principle of incentive based price cap regulation, including operating, investment and financing performance.

Accordingly, the level of dividend has been declared by reference to:

- the Company's ability to finance its functions;
- the Company's cumulative financial performance and past outperformance; and
- maintaining the Company's stable strong investment grade credit ratings.

A special dividend of £18.9m was proposed for the year ended 31 March 2018, and paid after the balance sheet date on 3 April 2017. This related to the profit on the sale of NWL's non-household retail business to NWGB, as described in note 2, and the enduring working capital benefit which NWL will gain as a consequence of this transaction.

10. PROPERTY, PLANT AND EQUIPMENT

	FREEHOLD LAND AND BUILDINGS £'m	INFRASTRUCTURE ASSETS £'m	OPERATIONAL STRUCTURES, PLANT AND MACHINERY £'m	FIXTURES, FITTINGS, TOOLS AND EQUIPMENT £'m	ASSETS IN THE COURSE OF CONSTRUCTION £'m	TOTAL £'m
Cost:						
At 1 April 2016	145.9	2,609.2	2,774.6	258.3	118.3	5,906.3
Additions	-	13.0	(0.3)	-	212.5	225.2
Schemes commissioned	3.6	70.0	98.5	26.7	(198.8)	-
Reclass to assets held for resale	-	-	-	(3.7)	-	(3.7)
Disposals	-	(1.4)	(1.7)	-	-	(3.1)
At 31 March 2017	**149.5**	**2,690.8**	**2,871.1**	**281.3**	**132.0**	**6,124.7**
Depreciation:						
At 1 April 2016	53.6	330.1	1,163.2	189.8	-	1,736.7
Charge for the year	2.9	26.8	83.8	17.0	-	130.5
Disposals	-	(1.3)	(1.7)	-	-	(3.0)
At 31 March 2017	**56.5**	**355.6**	**1,245.3**	**206.8**	**-**	**1,864.2**
Carrying value:						
At 31 March 2017	93.0	2,335.2	1,625.8	74.5	132.0	4,260.5
At 31 March 2016	92.3	2,279.1	1,611.4	68.5	118.3	4,169.6
Leased assets included above:						
Carrying value:						
At 31 March 2017	-	44.3	16.8	-	-	61.1
At 31 March 2016	-	44.8	18.0	-	-	62.8

Operational structures, plant and machinery include an element of land dedicated to those assets. It is not possible to separately identify the value of all land assets.

Cumulative borrowing costs capitalised in the cost of property, plant and equipment amount to £35.2m (2016: £30.0m). The capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation was 5.0% (2016: 5.62%).

11. FINANCIAL INVESTMENTS

	LOANS TO GROUP COMPANIES £'m
At 1 April 2016 and 31 March 2017	160.9

(a) Loans to Group Companies

In May 2004, the Company made a loan of £159.0m to Northumbrian Services Limited (NSL), maturing in January 2034. Following a restructuring of the NWGL group, this loan was reassigned to NWGL on 29 March 2016 at a variable interest rate of LIBOR plus 1% calculated on twice yearly payment dates.

In May 2004, the Company made a loan of £1.5m to Bakethin Holdings Limited, maturing in January 2034. The interest on the loan is capitalised and at 31 March 2017 the balance was £1.9m (2016: £1.9m).

(b) Subsidiaries

The Company's interests in subsidiaries at 31 March 2017 were as follows:

NAME OF UNDERTAKING	COUNTRY OF INCORPORATION OR REGISTRATION AND OPERATION	DESCRIPTION OF SHARES HELD	PROPORTION OF NOMINAL VALUE OF ISSUED SHARES HELD BY COMPANY (%)	BUSINESS ACTIVITY
Northumbrian Water Finance plc	England and Wales	Ordinary shares of £1	100	Holding of finance instruments
Reiver Finance Limited	England and Wales	Ordinary shares of £1	100	Special purpose financing vehicle
Reiver Holdings Limited	England and Wales	Ordinary shares of £1	100	Holding company

The registered office of all subsidiaries listed above is Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

The Company also has two quasi-subsidiary special purpose entities, Bakethin Holdings Limited, which is wholly owned by Bakethin Charitable Trust, and Bakethin Finance plc, which is a wholly owned subsidiary of Bakethin Holdings Limited. The principal activity of Bakethin Finance plc is as a special purpose financing vehicle.

The registered office of the two quasi-subsidiaries is c/o Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, United Kingdom, EC2R 7AF.

12. INVENTORIES

	2017 £'m	2016 £'m
Raw materials and consumables	2.8	2.4

13. TRADE AND OTHER RECEIVABLES

	2017 £'m	2016 £'m
Trade receivables	157.8	177.2
Doubtful debt provision	(85.0)	(83.7)
Income tax receivable	-	10.7
Amounts owed by other Group companies	4.4	4.8
Other receivables	29.1	4.7
Prepayments and accrued income	54.7	72.0
	161.0	**185.7**

14. ASSETS HELD FOR RESALE

As described in note 2, NWL exited the non-household retail market at 1 April 2017 and transferred the associated non-household retail business to an acquiring licenced retailer, NWGB, another subsidiary of NWGL.

As part of this transfer the following assets and liabilities have been reclassified from their original Balance Sheet heading to Assets held for resale as at 31 March 2017:

	£'m
Property, plant and equipment	3.7
Trade debtors	22.7
Doubtful debt provision	(1.1)
Prepayments and accrued income	17.1
Total assets held for resale as at 31 March 2017	**42.4**

15. TRADE AND OTHER PAYABLES

	2017 £'m	2016 £'m
Trade payables	29.5	8.7
Amounts owed to other Group companies	11.1	13.7
Amounts owed to related parties	0.6	3.8
Taxation and social security	3.7	3.5
Income tax payable	3.0	-
Other payables	24.2	24.9
Accruals and deferred income	98.1	103.4
	170.2	**158.0**

16. LOANS AND BORROWINGS

	2017 £'m	2016 £'m
Current:		
Bank overdrafts	1.2	2.5
Current instalments due on external borrowings	45.3	-
Current instalments due on internal borrowings	221.6	94.3
	268.1	**96.8**
Non-current:		
Non-current instalments due on external borrowings	480.8	558.7
Non-current instalments due on internal borrowings	1,898.0	1,889.1
	2,378.8	**2,447.8**

(a) External borrowings:

Loans wholly repayable within five years amount to £102.0m (2016: £190.8m).

Loans not wholly repayable within five years amount to £424.1m (2016: £367.9m) and bear interest rates in the range 1.47% to 5.35%.

The fair value loss on the Company's outstanding interest rate swaps in the year to 31 March 2017 was £14.5m (2016: £7.8m) in relation to interest rate swaps with a notional principal of £350.0m (2016: £360.0m).

(b) Internal borrowings:

NWF issued £200m and £150m Guaranteed Eurobonds in February 1998 and September 2001 respectively, maturing February 2023, with an annual coupon of 6.875%. The issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £194.2m and £163.2m respectively. Finance costs allocated during the year amounted to £0.2m (2016: £0.2m). Amortisation of loan issue receipts during the year amounted to £0.3m (2016: £0.3m).

NWF issued £300m Guaranteed Eurobonds in December 2001, maturing October 2017, with an annual coupon of 6.0%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £301.0m. In October 2016, NWF redeemed £120m in advance of the maturity date, with the Company settling the same amount on the inter-company loan. Amortisation of loan receipts during the year amounted to £0.1m (2016: £0.1m).

NWF issued £250m and £100m Guaranteed Eurobonds in December 2002 and December 2004, maturing April 2033 with an annual coupon of 5.625%. Both issues were guaranteed by the Company who received the issue proceeds by way of inter-company loans of £246.6m and £100.8m respectively. Finance costs allocated during the year amounted to £0.2m (2016: £0.2m).

NWF issued £150m Guaranteed Index Linked Eurobonds in September 2005, maturing July 2036, with a real coupon of 2.033%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £150.0m. Indexation accretion during the year amounted to £3.8m (2016: £2.1m).

NWF issued £60m Guaranteed Index Linked Eurobonds in January 2006, maturing January 2041, with a real coupon of 1.6274%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £60.0m. Indexation accretion during the year amounted to £1.5m (2016: £0.8m).

NWF issued two £100m Guaranteed Index Linked Eurobonds in June 2006 with real coupons of 1.7118% and 1.7484% and with maturities of 2049 and 2053 respectively. Both issues were guaranteed by the Company who received the issue proceeds by way of two inter-company loans of £100.0m. Indexation accretion during the year amounted to £5.0m (2016: £2.7m).

NWF issued £360m Guaranteed Eurobonds in January 2012, maturing January 2042, with an annual coupon of 5.125%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £338.8m. Finance costs allocated during the year amounted to £0.7m (2016: £0.7m).

NWF issued £300m Guaranteed Eurobonds in October 2016, maturing October 2026, with an annual coupon of 1.625%. The issue was guaranteed by the Company who received the issue proceeds by way of an inter-company loan of £297.6m. Finance costs allocated during the year amounted to £0.1m (2016: £nil).

17. OBLIGATIONS UNDER HIRE PURCHASE CONTRACTS AND FINANCE LEASES

(a) Obligations under hire purchase contracts and finance leases are as follows:

	2017 £'m	2016 £'m
Amounts due:		
Within one year	56.2	8.5
In the second to fifth years inclusive	16.2	66.3
After five years	75.9	78.7
	148.3	**153.5**
Less:		
Finance charge allocated to future periods	(39.1)	(43.8)
	109.2	**109.7**
Disclosed as due:		
Current liability	56.2	8.5
Non current liability	53.0	101.2
	109.2	**109.7**

(b) Lease commitments:

The Company has entered into non-cancellable operating leases in respect of land and buildings, plant, machinery and motor vehicles. The future minimum rentals payable under non-cancellable operating leases are as follows:

	2017 £'m	2016 £'m
Not later than one year	1.2	1.1
After one year but not more than five years	4.2	4.5
After five years	34.5	35.4
	39.9	**41.0**

18. PROVISIONS

	£'m
Pension provision for former employees:	
At 1 April 2016	1.6
Utilised during the period	(0.2)
At 31 March 2017	**1.4**
Analysed as:	
Current	0.2
Non-current	1.2
	1.4

The provision mainly represents outstanding pension liabilities for pensions that have been awarded on a discretionary basis, mainly to former employees of water companies which have since merged with the Company. These pension liabilities have been calculated by an independent actuary, using the same actuarial assumptions as applied to the defined benefit pension scheme, and are expected to be paid over the remaining lives, which is approximately six years.

In the ordinary course of business, the Company is sometimes subject to claims and potential litigation, whether from regulatory bodies, individuals or particular groups, related to one off matters. The Directors consider that, where it is possible to be estimated, a reasonable and appropriate position has been taken in reflecting such items in these financial statements in note 15 and the note above.

It is not currently possible to estimate the financial effect and likely timing of any associated outflow of some matters, given that some are in early stages of discussion, the limited likelihood of the claims against the Company being successful, or the potential range of possible outcomes, and accordingly no provision has been made in the financial statements. No reasonably possible financial outcome that would be significant to the financial statements has been identified in relation to these remaining matters at the date of the issue of these Financial Statements.

19. GRANTS AND DEFERRED INCOME

	CAPITAL GRANTS AND CONTRIBUTIONS £'m	PROCEEDS FROM KIELDER SECURITISATION £'m	TOTAL £'m
At 1 April 2016	383.9	127.9	511.8
Additions	34.7	-	34.7
Amortised during the year	(6.1)	(7.1)	(13.2)
At 31 March 2017	**412.5**	**120.8**	**533.3**

The Kielder securitisation involved the assignment of the right to the future income stream associated with the Kielder operating contract until 2034 to Reiver Finance Limited, a subsidiary company, in return for consideration of £212.1m. This capital sum is amortised to the income statement of the Company over the life of the assignment.

20. FINANCIAL INSTRUMENTS

	2017 £'m	2016 £'m
Financial liabilities that are designated and effective as hedging instruments carried at fair value:		
Interest rate swaps	17.6	16.3
Power forward contracts	8.7	13.6
Foreign exchange contracts	(0.5)	-
Financial liabilities carried at fair value through profit and loss:		
Interest rate swaps	13.7	0.5
Fuel hedges	0.1	0.9
	39.6	**31.3**

At 31 March 2017, the Company held the following interest rate swaps, designated as hedges of future interest cash flows, used to convert variable rate interest payments to a fixed rate basis:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	FIXED RATE
£100.0m	15 September 2008	15 March 2022	4.79%
£150.0m	15 October 2015	15 October 2025	2.36%

At 31 March 2017, the Company held the following interest rate swaps, designated as hedges of future interest cash flows, used to convert variable rate interest payments to a fixed rate basis:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	INDEX LINKED RATE
£150.0m	15 October 2015	15 October 2025	(0.42%)

At 31 March 2017, the Company held the following forward power contracts, designated as hedges of expected future purchases:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	PRICE PER MWH £
166,896 MWH	1 April 2018	30 September 2018	50.7
165,984 MWH	1 October 2018	31 March 2019	56.2
166,896 MWH	1 April 2019	30 September 2019	52.2
166,896 MWH	1 October 2019	31 March 2020	56.8

At 31 March 2017, the Company held the following fuel hedge, designated as a hedge of expected future purchases:

NOTIONAL AMOUNT	START DATE	TERMINATION DATE	PRICE PER LITRE £
3,000,000 litres	1 April 2017	31 March 2018	0.3250
3,000,000 litres	1 April 2018	31 March 2019	0.3435
3,000,000 litres	1 April 2019	31 March 2020	0.3562

20. FINANCIAL INSTRUMENTS (continued)

At 31 March 2017, the Company held the following forward exchange contracts, designated as hedges of expected future purchases for which the Company has firm commitments. The forward currency contracts are being used to hedge the foreign currency risk of the firm commitments. The terms of these contracts are as follows:

CURRENCY BOUGHT	MATURITY	EXCHANGE RATE	TRANSACTION VALUE £'m
USD 1,245,000	4 April 2017	1.4454	0.9
USD 978,630	13 April 2017	1.5072	0.6
USD 91,000	28 April 2017	1.2365	0.1
USD 1,112,000	31 May 2017	1.2375	0.9
USD 1,245,000	4 April 2018	1.4492	0.9
USD 1,112,000	31 May 2018	1.2500	0.9
USD 1,245,000	4 April 2019	1.4550	0.8
USD 1,112,000	31 May 2019	1.2645	0.9
USD 1,245,000	13 March 2020	1.4600	0.8
			6.8

At 31 March 2016, the Company held the following forward exchange contracts, designated as hedges of expected future purchases for which the Company has firm commitments. The foward currency contracts are being used to hedge the foreign currency risk of the firm commitments. The terms of these contracts are as follows:

CURRENCY BOUGHT	MATURITY	EXCHANGE RATE	TRANSACTION VALUE £'m
USD 978,630	15 April 2016	1.5044	0.7
USD 978,630	15 April 2017	1.5072	0.6
USD 275,100	18 April 2016	1.4440	0.2
USD 1,245,000	4 April 2016	1.4449	0.9
USD 1,245,000	4 April 2017	1.4454	0.9
USD 1,245,000	4 April 2018	1.4492	0.9
USD 1,245,000	4 April 2019	1.4550	0.8
USD 1,245,000	13 March 2020	1.4600	0.8
			5.8

21. SHARE CAPITAL

	2017 £'m	2016 £'m
Authorised:		
122,650,000 Ordinary Shares of £1 each (31 March 2016: 122,650,000)	122.7	122.7
Allotted, called-up and fully paid:		
122,650,000 Ordinary Shares of £1 each (31 March 2016: 122,650,000)	122.7	122.7

NWL is a company limited by shares.

22. FINANCIAL COMMITMENTS

(a) Capital commitments.

	2017 £'m	2016 £'m
Contractual commitments for the acquisition of property, plant and equipment	134.6	144.2

In addition to these commitments, the Company has longer term expenditure plans, including investment to deliver business outcomes, maintain the health of the asset base and provide for new demand and growth in the regulated part of the business.

(b) Foreign currency commitments

At 31 March 2017 the Company held forward foreign exchange contracts of £6.8m (2016: £5.8m) for the purpose of hedging the foreign currency risk of committed future purchases.

23. PENSIONS

NWL participates in the Group defined benefit pension scheme, NWPS, providing benefits to 1,340 active members at 31 March 2017 (2016: 1,446). The assets of the NWPS are held separately from those of the Group in independently administered funds.

The most recent actuarial valuation of the NWPS was at 31 December 2013. At that date, the value of assets amounted to £785.9m and the liabilities were £946.2m, resulting in a deficit of £160.3m and a funding level of 83.1%. The finalisation of this valuation was deferred until November 2015, allowing it to reflect changes to the Scheme made after a consultation with members, which agreed a number of changes to the original proposal.

The main changes to the scheme, which took effect from 1 January 2016, were to base benefits on a career average revalued earnings (CARE) basis, changing from a final salary basis, with accrued benefits at the date of implementation to be revalued in line with CPI and future CARE accrual to be revalued at RPI, both capped at 2.5%. The next actuarial valuation of the NWPS has commenced and will be dated as at 31 December 2016.

The future service contribution rate, jointly payable by members and the employers from 1 January 2016, is 29.4% of pensionable salaries. Members' contributions are 7.3% on average with the employers paying 22.1%, including 1.5% in respect of insurance premiums and expenses. In addition, the employers committed to making deficit reduction payments of £11m per annum, commencing 1 April 2015, increasing annually by RPI.

Employer contributions of £28.1m were paid in the year to 31 March 2017, of which £11.1m related to deficit reduction. For the year to 31 March 2018, employer contributions are projected to be £26.2m, including £11.4m in respect of deficit reduction.

The Scheme also has a defined contribution section which had 1,779 active members at 31 March 2017 (2016: 1,530). Members can choose to contribute either 3%, 4% or 5% of salary, with employers contributing at either 6%, 7% or 8% depending on the member contribution rate. The contributions paid to the defined contribution section by the Company in the year totalled £5.1m (2016: £4.4m).

The additional disclosures regarding the defined benefit scheme as required under FRS 101 and the relevant impact on the financial statements are set out below. A qualified actuary, using revised assumptions that are consistent with the requirements of FRS 101 has updated the actuarial valuation described above as at 31 March 2017. Investments have been valued, for this purpose, at fair value.

23. PENSIONS (continued)

FRS 101 ACTUARIAL ASSUMPTIONS:	2017	2016
Discount rate	2.6%	3.6%
Pay increases[1]	3.1%	3.0%
Price inflation (RPI)	3.1%	2.9%
Price inflation (CPI)	2.1%	1.9%
Pension increases linked to RPI	3.1%	2.9%
Pension increases linked to CPI	2.1%	1.9%
Mortality assumptions[2]		
- Life expectancy for a member aged 65 - female (years)	24.1	24.9
- Life expectancy for a member aged 65 - male (years)	22.0	23.2

1. including promotional salary scale
2. scheme specific bespoke 'Vitacurves' which reflect the characteristics of the Scheme membership

The fair value of the assets in the NWPS and the present value of the liabilities in the Scheme are shown below:

	2017 £'m	2016 £'m
Equities	296.8	350.5
Debt securities	375.3	278.4
Property related funds	108.6	105.4
Cash	12.7	31.7
Other	186.0	104.2
Total fair value of assets	**979.4**	**870.2**
Present value of liabilities	**(1,132.5)**	**(960.1)**
Deficit	**(153.1)**	**(89.9)**

The amounts recognised in the income statement and in the statement of comprehensive income are analysed as follows:

RECOGNISED IN THE INCOME STATEMENT:	2017 £'m	2016 £'m
Current service cost	13.4	14.9
Administration cost	1.5	1.7
Past service cost	1.7	0.8
Exceptional pension credit	-	(38.9)
Recognised in operating costs in arriving at operating profit	**16.6**	**(21.5)**

23. PENSIONS (continued)

	2017 £'m	2016 £'m
Net interest cost on plan obligations	2.8	2.1
Recognised in finance costs	**2.8**	**2.1**

RECOGNISED IN THE STATEMENT OF COMPREHENSIVE INCOME:	2017 £'m	2016 £'m
Changes in demographic assumptions	49.3	(7.5)
Changes in financial assumptions	(223.5)	49.7
Return on assets (excluding amounts included in finance costs)	94.6	(25.5)
Other actuarial gains / (losses)	7.7	(66.2)
Net actuarial losses	**(71.9)**	**(49.5)**
Contributions made by associated company	0.2	-
Net actuarial losses	**(71.7)**	**(49.5)**

The exceptional pension credit is explained in note 4 on page 88.

Changes in the present value of the defined pension obligation are analysed as follows:

	2017 £'m	2016 £'m
At start of period	960.1	970.9
Current service cost	13.4	14.9
Administration cost	1.5	1.7
Past service cost	1.7	0.8
Exceptional pension credit	-	(38.9)
Interest cost	33.4	31.0
Contributions by plan participants	0.1	0.2
Benefits paid	(44.2)	(44.5)
Remeasurement:		
Changes in demographic assumptions	(49.3)	7.5
Changes in financial assumptions	223.5	(49.7)
Other actuarial gains and losses	(7.7)	66.2
At end of period	**1,132.5**	**960.1**

23. PENSIONS (continued)

Changes in the fair value of plan assets are analysed as follows:

	2017 £'m	2016 £'m
At start of period	870.2	884.2
Interest income on scheme assets	30.6	28.9
Contributions by employer	28.1	26.9
Contributions by plan participants	0.1	0.2
Benefits paid	(44.2)	(44.5)
Return on assets (excluding amounts included in finance costs)	94.6	(25.5)
At end of period	**979.4**	**870.2**

Nature of benefits, regulatory framework and other entity's responsibilities for governance of the Scheme

The Scheme is a registered defined benefit scheme subject to the UK regulatory framework for pensions, including the scheme specific funding requirements. The Scheme is operated under trust and as such, the Trustee of the Scheme is responsible for operating the Scheme and they have a statutory responsibility to act in accordance with the Scheme's Trust Deed and Rules, in the best interest of the beneficiaries of the Scheme, and UK legislation (including Trust law). The Trustee has the power to set the contributions that are paid to the Scheme.

Risks to which the Scheme exposes the Company

The nature of the Scheme exposes the Company to the risk of paying unanticipated additional contributions to the Scheme in times of adverse experience. The most financially significant risks are likely to be:

- members living for longer than expected;
- higher than expected actual inflation and salary increase experience;
- lower than expected investment returns; and
- the risk that movements in the value of the Scheme's liabilities are not met by corresponding movements in the value of the Scheme's assets.

Asset-liability matching strategies used by the Scheme or the Company

The Scheme does not currently use any asset-liability matching strategies. The Trustee's current investment strategy, having consulted with the Company, is to invest the majority of the Scheme's assets in a mix of equities and corporate bonds, in order to strike a balance between:

- maximising the returns on the Scheme's assets; and
- minimising the risks associated with lower than expected returns on the Scheme's assets.

The Trustee is required to regularly review their investment strategy in light of the revised term and nature of the Scheme's liabilities.

23. PENSIONS (continued)

Sensitivity to key assumptions

The costs of a pension arrangement require estimates regarding future experience. The financial assumptions used for FRS 101 reporting are the responsibility of the Directors of the Company. These assumptions reflect market conditions at the balance sheet date. Changes in market conditions which result in changes in the net discount rate (essentially the difference between the discount rate and the assumed rates of increases of salaries, deferred pension revaluation or pensions in payment), can have a significant effect on the value of the liabilities reported.

Impact of changes in assumptions compared with actuarial assumption for the NWPS:

ACTUARIAL VALUE OF LIABILITIES ON 31 MARCH 2017:	£'m
0.5% decrease in discount rate	1,246.6
1 year increase in life expectancy	1,166.5
(0.5%) change in inflation	1,038.3

MATURITY PROFILE OF THE DEFINED BENEFIT OBLIGATION FOR THE YEAR ENDED 31 MARCH 2017:

	NUMBER OF MEMBERS	LIABILITY SPLIT (%)	DURATION (YEARS)
Active members	1,340	34	26
Deferred members	1,175	15	24
Pensioners	3,200	51	13

24. RELATED PARTY DISCLOSURES

The Company is a wholly owned subsidiary of NWGL, whose publicly available consolidated financial statements include the Company. Accordingly, the Company is exempt under the terms of FRS101 from disclosing transactions with other members of the Group headed by NWGL.

Transactions with related parties outside of the NWGL group comprised purchases of £11.0m (2016: £12.4m), sales of £0.2m (2016: £0.1m) and payment for prior year consortium tax relief of £3.8m (2016: £9.5m). As at 31 March 2017 £0.9m (2016: £0.1m) is owed from these companies in respect of sales or rebates, and £0.8m (2016: £nil) is owed to these companies in respect of purchases.

The Company acquires vehicles from Vehicle Lease and Service Limited, an associated company, on a finance lease basis. During the year, new finance leases of £3.9m (2016: £1.6m) were entered into and capital repayments of £3.5m (2016: £3.3m) were made. The year end finance lease creditor was £9.4m (2016: £9.0m).

£0.6m (2016: £3.8m) is owed in respect of tax losses surrendered by Hutchison 3G UK Holdings Limited (note 15).

The companies with which NWL had transactions during the year, included in the above balances, were as follows:

- CK Infrastructure Holdings Limited;
- Northern Gas Networks Limited;
- Hutchison 3G UK Holdings Limited;
- Hutchison Whampoa (Europe) Limited; and
- Vehicle Lease and Service Limited.

25. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

In the Directors' opinion, the Company's ultimate parent undertaking and controlling party is CKHH, a company listed on the Hong Kong Stock Exchange. This is the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the reporting company is a member. Copies of CKHH's group financial statements, which include the Company, are available from http://www.ckh.com.hk/en/ir/annual.php.

The parent undertaking of the smallest group of undertakings for which group financial statements are drawn up, and of which the reporting company is a member, is NWGL, which is incorporated in England and Wales. Copies of NWGL's group financial statements will be available in due course from Northumbria House, Abbey Road, Pity Me, Durham DH1 5FJ.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHUMBRIAN WATER LIMITED

We have audited the Financial Statements of Northumbrian Water Limited for the year ended 31 March 2017 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity and the related notes 1 to 25.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) including FRS 101 Reduced Disclosure Framework.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion the Financial Statements:

- give a true and fair view of the state of the Company's affairs as at 31 March 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Governance Report (including the Directors' Report) for the financial year for which the Financial

continued...

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHUMBRIAN WATER LIMITED (continued)

Statements are prepared is consistent with the Financial Statements; and

- the Strategic Report and the Governance Report (including the Directors' Report) have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Governance Report (including the Directors' Report).

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Anthony Matthews

Anthony Matthews (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Newcastle Upon Tyne
United Kingdom
14 July 2017

Northumbrian Water Limited
Northumbria House
Abbey Road
Pity Me
Durham
DH1 5FG

www.nwl.co.uk | **www.eswater.co.uk** | **www.welivewater.co.uk**